Responsible Business Theory and Accounting

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Abstract

This paper sets out a new notion of responsible business theory and examines its relationship with accounting. Responsible business research – that is, a strand of normative management scholarship advancing various concepts of "responsible business" and the role of the corporation - has significantly influenced management and accounting practice, but congruence between the two areas remains challenging. We distil the normative literature into four widely referenced categories – shareholder primacy, enlightened shareholder value, stakeholder theory and corporate purpose as system stewardship. Enlightened shareholder value is conceptually indistinguishable from shareholder primacy; in contrast, stakeholder theory is markedly different in principle but lacks the coherence and practical relevance that corporate purpose as system stewardship seeks to provide.

There are four forms of accounting that have been advocated to correspond to these different notions of responsible business. With a strong focus on measurement and shareholder value creation, fair value accounting and narrative reporting (which now encompasses environmental, social and governance and corporate social responsibility) underpin shareholder primacy and enlightened shareholder value respectively, whereas social and environmental accounting is critical for stakeholder theory. None of these theories or forms of accounting have effectively delivered responsible business that meets the challenges of system stewardship.

In contrast, the concept of corporate purpose as system stewardship (a key element of what we call "the purposeful company") set out here requires companies to account appropriately for costs of remedying detriments to and investing in their stakeholders in determining their profits. This potentially can align the interests of companies with stakeholders and ensures that profits derive from activities and investments that benefit both shareholders and stakeholders. It thereby resolves the failures of accountability and enforcement that undermine the other three categories of responsible business.

Keywords: **Responsible business theories of the firm, shareholder primacy, enlightened shareholder value, stakeholder theory, purposeful business, fair value, environmental, social and governance accounting and reporting, and cost accounting**

1. Introduction

Following a long period during which shareholder primacy reigned supreme, there has been rapidly mounting interest in responsible business practices. These look to corporations to deliver value not just to shareholders but to a broad range of stakeholders including employees, society, and the natural environment. Much hope is being placed on responsible business to tackle the challenges of people and our planet in the 21st century, to act as "agents of the system that sustain market capitalism"[1] and as stewards of not only financial but social capital too[2]. Recent calls to extend corporate stewardship responsibility to natural capital as well[3].

There have been corresponding advances in research agendas relating to management, accounting, governance, and investment, but there is a need to clarify how theories and practices relate to each other. The article contributes to this by seeking to bridge responsible management and accounting. Taking a historically informed perspective, we trace different categories of "responsible management", which advance various views on the role of the corporation. Such notions have implications for management strategies and to what extent those are undertaken in the interests of stakeholders other than shareholders.[4] Responsibility accounting (henceforth 'accounting') focuses on the financial and nonfinancial performance of firms. There is a need to understand how these two streams relate to each other, and how their recommended practices co-develop as they are adopted by corporations and shaped further by management and accounting practice.

The interdependence between management and accounting has been understood in relation to traditional theories of the firm,[5] but recent advances in responsible business suggest a need to revisit this linkage. This article does that by exploring how accounting practices (in particular, different notions of profitability and non-financial performance) relate to the changing and varied conceptualizations of what it takes for a business to be "responsible".

Accounting has been an active subject of research in two areas relevant to this essay. The first is historical accounting studies surveying the development of cost accounting and managerial control practices[6] and the history of profit[7], as well as environmental, social and governance (ESG) accounting.[8] These studies suggest that accounting is contingent and corresponds to the prevailing notions of economic development, accountability, the power relations between corporate shareholders and other stakeholders, and the perceived role(s) of the corporation.

The second body of accounting research of relevance here is normative and practical in orientation, and concerns itself with accounting procedure, technique and the "right" type of

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[1] Henderson, R., & Ramanna, K. (2015). Do Managers Have a Role to Play in Sustaining the Institutions of Capitalism? Retrieved from Center for Effective Public Management at Brookings website: https://www.brookings.edu/wp-content/uploads/2016/06/BrookingsInstitutionsofCapitalismv5.pdf

[2] Chen RS. 1975. Social and financial stewardship. The Accounting Review 50(3): 533–543.

[3] Rebecca Henderson: Reimagining capitalism in a world on fire

[4] John Elkington (1994), "Towards the Sustainable Corporation: Win-Win-Win Business Strategies for Sustainable Development", *California Management Review*, *36*, 90–100.

[5] Jonas Gerdin, Martin Messner and Jan Mouritsen (2014), "On the Significance of Accounting for Managerial Work", *Scandinavian Journal of Management*, *30*, 389–394.

[6] Kaplan, Robert S. "The Evolution of Management Accounting." *The Accounting Review* 59.3 (1984): 390-418.

[7] Levy, Jonathan. "Accounting for Profit and the History of Capital." Critical Historical Studies 1.2 (2014): 171-214.

[8] Brown, Judy, and Fraser, Michael. "Approaches and Perspectives in Social and Environmental Accounting: An Overview of the Conceptual Landscape." *Business Strategy and the Environment* 15.2 (2006): 103-17.

performance measurement. Normative accounting research ponders the weaknesses of current accounting practice and its possible reform: how to bring accounting in line with the demands of the time and context in which it is practised?

Such reflection and initiative ushered in now classic ("traditional") accounting practices, such as historic-cost and ROI-accounting a century ago, which saw corporations through the "golden age of capitalism" up to the 1970s. With deindustrialization and the conglomerate movement in the West, the focus shifted to a financial conception of the corporation, heralding in the notions of shareholder value primacy and mark-to-market accounting. Concerns with the unintended consequences of shareholderism and a seemingly unstoppable short-term bias led normative accounting theorists to recommend non-financial performance measurement frameworks (ranging from the balanced scorecard to ESG metrics), which were employed to address – with varying degrees of take-up and success - long-term, intangible value creation and a growing plurality of affected stakeholders. While the historical and normative approaches overlap, they are conceptually quite distinct.

This article makes three contributions to the responsible business research agenda. The first is to distil the broad discourse on responsible management and accounting into four categories, each characterised by both a management and an accounting concept: traditional shareholder primacy, the enlightened shareholder value view of the firm, stakeholder theory, and corporate purpose as system stewardship. The second contribution is to assert that none of the first three theories of responsible business have delivered what has been expected or is required of them. This, we argue, is in large part due to the insufficient attention and treatment that their corresponding accounting practices gave to the trade-offs and negative externalities involved in delivering inescapably pluralistic corporate agendas (be they shareholder- or stakeholder-oriented). The third is to make the case for a new style of accounting - one that can solve the measurement conundrum surrounding negative externalities. Such accounting is needed to redefine corporate purpose (in line with the notion of system stewardship, creating value without creating detriments for people and the planet) and to resolve the deficiencies of accountability and enforceability that plague the other three categories.

The paper argues that there are limitations to the protection that both traditional shareholder primacy and enlightened shareholder value approaches provide stakeholders, and correspondingly limited incorporation of the interests of stakeholders in their accounting methodologies. In contrast, stakeholder theory seeks to be all encompassing. However, it has two serious limitations. First, the measurement and accounting requirements it imposes are formidable and difficult to implement with the precision, assurance and validation that would normally be expected of accounting and reporting systems. Second, while it is encompassing, it is not necessarily protective of stakeholders whose interests may diverge from and therefore be overridden by those of shareholders.

Instead, the paper argues that the approach of "system stewardship" to define corporate purpose - in looking to companies to profit from promoting the wellbeing of certain stakeholders while not profiting from inflicting detriments on others - is both more practical and protective of stakeholder (and ultimately, shareholder) interests. In particular it relates the notion of profit to enhancing the wellbeing of certain stakeholders by requiring companies to account for the costs of remedying detriments they impose on other stakeholders and capitalizing expenditures that confer benefits on stakeholders over multiple accounting periods. Profits are therefore diminished where detriments need to be remedied and would otherwise be earned at the

expense of other stakeholders but increased where companies make investments in their stakeholders.

This view of corporate purpose promotes and protects the interests of stakeholders both conceptually and practically by encouraging firms to make profitable investments in specific stakeholders while avoiding profiting through underinvesting in any stakeholder. It thereby addresses concerns about the limitations of enlightened as well as traditional shareholder primacy and the impracticality of stakeholder theory. While ESG accounting and other forms of social and environmental accounting are relevant to enlightened shareholder value, stakeholder theory and corporate purpose, with their focus on (often arbitrary) non-financial measurement, ESG and social and environmental accounting are not sufficient for evaluating the resourcing needs and performance of the "purposeful company", as defined here. Metrics to assess corporate purpose should be specific to a firm's purpose as well as generic enough for comparability across companies.

Section 2 describes the four categories of responsible business and the merits and deficiencies of each. Section 3 considers how the theories relate to systems of measurement, accounting, and valuation. Section 4 concludes with a discussion of the implications of the paper for reforms to measurement that will be needed over the current decade.

2. Four Categories of Responsible Business

2.1 Shareholder Primacy

Shareholder primacy has its roots in proprietary theory, starting with Adam Smith's assertion "that individual acts of economic self-interest combine, through the 'invisible hand' of market forces, to further the best interests of society at large", "that the individual owner would necessarily . . . be solely entitled to all the fruits of his property, the profits" and that this individual would "use his industrial property and labour 'efficiently' and grow [the business] for the strict purpose of accumulating profit" for himself."[9]

This sole proprietorship justification for shareholder primacy extends to manager-run companies through the presumption of an equivalence of shareholder owned firms to sole proprietorships, and the resolution of the agency problem of management-run firms by regarding shareholders as the sole concern of management, placing their interests ahead of those of any other party including management itself. This is the basis of the Friedman Doctrine of there being "one and only social purpose of business to increase profits, so long as it stays within the rules of the game".

There are therefore three critical links in the case for shareholder primacy. The first is the assertion that market forces drive individual self-interest of sole proprietors to those of the collective interests of society; secondly, that the collective property view of a sole proprietorship extends to a property view of the stockholder corporation; and thirdly that there should be a complete alignment of the interests of management with their shareholders. In other words, shareholder primacy rests on a combination of competitive markets, collective property rights and complete resolution of agency problems. The chain is as strong as its weakest link

[9] Adam Smith (1776), *An Inquiry into the Nature and Causes of the Wealth of Nations.*

and all three are questionable – market dominance versus competition; "shareholders do not own firms" in a conventional sense; and "business judgment rules" of directors.

Nevertheless, the case of John and Horace Dodge, minority shareholders in the Ford Motor Corporation, brought against the founder and majority shareholder, Henry Ford, in relation to the suspension of payment of special dividends asserted the primacy of shareholders when the Michigan Supreme Court in 1919 concluded that:

> "A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among its stockholders in order to devote them to other purposes."[10]

While some attempted to restrict interpretation of the case to distribution of profits, it has been presented as a demonstration that the "theory of shareholder wealth maximization has been widely accepted by courts over an extended period of time"[11]

The importance of this historical perspective on corporate purpose is, first, to suggest that there is nothing in the origin or development of the corporation that intrinsically or necessarily associates it with maximizing profits. Purpose has been dictated by need and that is sometimes predominantly private and profitable in nature and at other times public and social, and frequently a combination of the two.

Second, history reminds us that the responsible-management debate reaches back well before current discussions of the roles and purpose of corporations. In the UK, the major turning point came with the election of Margaret Thatcher as prime minister in 1979. Rejecting the post-Second World War Tory consensus with Labour, Thatcher's economic policies set out to dismantle the mixed economy. Abolishing capital controls, reducing union power and privatizing state-owned enterprises created not only the setting for the "new capitalism"[12], but also ushered in a new managerial ethos – shareholderism. Nevertheless, the triumph of shareholder value primacy was conditional on major societal challenges and changes. It cannot be assumed to last longer than its historical determinants and the role it fulfils.

Third, history teaches us that the shareholderism versus stakeholderism debate is an at least two-century long contest among the constituents of the corporation, in which the redistribution of wealth and power to non-shareholder constituencies has been at stake.[13] Shareholders did not always rule supreme. For example, The American Business Creed (1956), co-authored by four prominent Keynesian economists, referred to management's "sphere of unhampered discretion and authority which is not merely derivative from the property rights of owners." For "stockholders" had "no special priority; they are entitled to a fair" return on their investment, but profits above a 'fair' level were seen as an economic sin.

The Creed emerged in an era of unprecedented corporate generosity towards employees and communities – managers actively pursued what the transaction-cost economist Oliver

[10] *Dodge v. Ford Motor Company*, 204 Mich. 459, 170 N.W. 668 (Mich. 1919).

[11] Stephen Bainbridge (2012), "Case Law on the Fiduciary Duty of Directors to Maximize the Wealth of Corporate Shareholders" @ ProfessorBainbridge.com

[12] Richard Sennett (2006), *The Culture of New Capitalism*. Yale University Press.

[13] Brown, Judy, and Fraser, Michael. "Approaches and Perspectives in Social and Environmental Accounting: An Overview of the Conceptual Landscape." *Business Strategy and the Environment* 15.2 (2006): 103-17.

Williamson in 1963 referred to as "discretionary" or "non-profit" goals – justified and rationalized by the long-term focus implicit in the premier performance metric of the day: return on investment (ROI), measured over the business cycle (Levy, 1994; Kaplan, 1984). Indeed, in corporate law, the "business judgment rule" granted the managers and directors of the "soulful corporation" wide discretion, while ROI created the performance framework for other values and concerns, even of the "non-profit" variety, to be brought back into the for-profit corporation. The Fordist corporation was not a profit-maximizing corporation – it was the "soulful corporation" investing in local baseball clubs, research and development budgets, factory architecture, or free cafeteria lunches.

With the decline of Keynesianism, the erosion of competitiveness of the U.S. and U.K. manufacturing industries, started a new economic era of deindustrialization. The corporation was viewed in financial terms as a "nexus of contracts" and as a portfolio of financial assets. Corporate finance and agency theory reigned supreme, and with them, the "soulful corporation" came to be seen as wasteful, its managers and directors as investing in employees and communities at the expense of shareholders.

From 1978, the Business Roundtable, an elite business lobbying group, periodically issued Principles of Corporate Governance that included language on the purpose of a corporation. In 1981, the Roundtable promoted the enlightened shareholder view by giving a nod to stakeholders (and the previous era), declaring that "balancing the shareholder's expectations of maximum return against other priorities is one of the fundamental problems confronting corporate management." By 1997 its focus swung firmly to shareholders: "In the Business Roundtable's view, the paramount duty of management and of boards of directors is to the corporation's stockholders; the interests of other stakeholders are relevant as a derivative of the duty to stockholders. The notion that the board must somehow balance the interests of stockholders against the interests of other stakeholders fundamentally misconstrues the role of directors."

While it is Milton Friedman who is most often credited with shareholder-maximization, his much cited opinion piece in the New York Times, entitled, "*A Friedman Doctrine-- The Social Responsibility Of Business Is to Increase Its Profits"* went largely unnoticed at the time. It came of age only a decade after its original publication, once the Anglo-Saxon world saw a striking resolution of all three of the assumptions underpinning shareholder primacy. First, the association of ownership with dispersed shareholders was addressed through the emergence of markets for corporate control – the conglomerate movement, hostile takeovers and later shareholder activism – which required management to maximize shareholder value to avoid becoming targets of bidders and activists. Second, the alignment of managerial interests with those of shareholders was achieved through high powered management incentive schemes involving shares and stock options. Finally, dominant firm abuse was tackled through intensification of anti-trust and competition policy.

By the beginning of the 1980s it appeared that all the conditions needed to justify shareholder primacy were in place and the theory reigned supreme, ushering in the economic doctrine of neoliberalism. However, cracks have been showing since the ultimate repercussions of neoliberal economic policies became evident in the UK and the U.S. Under the pressure of impatient shareholders, fuelled by financial deregulation and hostile takeovers, corporate culture was changing. Managers figured out that the easiest way to deliver quick profits was through downsizing - reducing workforces and minimizing investments - while 'corporate

raiders' engaged in asset stripping, regardless of its impact on the long-term viability of target companies or communities in which they operated.

2.2 Enlightened Shareholder Value

Enlightened Shareholder Value (ESV) represented a growing dissatisfaction with the social and environmental repercussions of neoliberal economics, and so-called "free-market capitalism." In the U.S., ESV has been present in ideas such as "instrumental stakeholder theory"[14] and "creating shared value."[15] In general, advocates maintain that business can transform social problems relevant to the corporation into business opportunities, and drive greater profitability along the way. In the UK, ESV has been codified in the UK Companies Act (2006), which integrated CSR thinking with commentators arguing that to redress the excesses of business, the shareholder primacy principle should be moderated. The Act was the outcome of an extensive process of consideration and consultation beginning with a consultative paper in 1998.[16]

Most contentious was the question of directors' duties.[17] The Company Law Review Steering Group "expressed the opinion that the law ought to be revised to bring it into line with existing best practice, encouraging directors to look beyond maximising short term returns to institutional shareholders towards the longer term and to recognise the roles that relationships with other stakeholders, such as employees, suppliers, customers and others affected by the company's commercial activities, play in the success of the company".[18]

There were two views about how this should be achieved. The first - Enlightened Shareholder Value (ESV) - maintained that the primary duty of directors is to maximize shareholder value. However, in so doing, particularly in promoting the success of the company for the benefit of its shareholders in the long-term, it emphasized the importance of a company's relationships with other parties – employees, customers, suppliers, communities, and the environment – in realizing this objective. ESV did not therefore represent a fundamental change in law but instead a codification of what was involved in promoting the interests of shareholders.

The second view, which the Company Law Review Group, categorized as "Pluralist" was essentially stakeholder theory, namely that directors should consider the interests of stakeholders in their own right, and regard shareholders as just one of the parties whose interests have to be taken into consideration. This alternative approach was rejected by the Review Group on "the grounds that it would confuse the issue of directors' duties, giving directors little in the way of guidance in decision-making. It also ran the risk of creating a litigious climate for business where those parties who felt they had not been treated as they would have liked by a company's directors sought recompense through the courts."[19]

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[14] T. Donaldson and L.E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications," *Academy of Management Review*, 20/1 (January 1995): 65-91.

[15] M.E. Porter and M.R. Kramer, "Strategy and Society: The Link between Competitive Advantage and Corporate Social Responsibility," *Harvard Business Review*, 84/12 (December 2006): 78-92; M.E. Porter and M.R. Kramer, "Creating Shared Value," *Harvard Business Review*, 89/1-2 (January/February 2011): 62-77.

[16] Modern Company Law: For a Competitive Economy, DTI, March 1998.

[17] House of Commons Trade and Industry Committee, The White Paper on Modernising Company Law: Sixth Report of Session 2002–03.

[18] Ibid. page 7, para. 10.

[19] Ibid, page 7, para 16.

In accepting ESV, UK company law therefore adopted shareholder primacy by another name. In emphasizing the success of the company in the long-term it acknowledged the interests of other parties but only in so far as they promote the interests of shareholders. It therefore relegates other parties' interests to those of shareholders. Put another way, it means that companies could still minimize wages and expenditures on the working conditions of their employees, produce addictive products, avoid paying taxes, and pollute the environment, provided any shareholder value benefits thereby created are not offset by adverse reputational or regulatory consequences. The water-extraction and plastic-waste scandals of Nestle[20], an ardent advocate of "creating shared value", illustrate the point.

2.3 Stakeholder Theory

In contrast to ESV, stakeholder theory suggests that business should take account of the interests of all its stakeholders in promoting the success of the company.[21] As Ed Freeman, the leading proponent of this managerial theory wrote, "[c]ertainly shareholders are an important constituent and profits are a critical feature of this activity, but concern for profits is the result rather than the driver in the process of value creation."[22] According to stakeholder theory, a company should seek to create value for all those contributing to and affected by the firm. All those who affect or are affected by the firm play a role in the success of the company and should be regarded as an end, not just a means to an end. So, management should seek to balance the interests of all its stakeholders.[23]

The "Constituency Statutes" introduced in the US in the 1980's and 1990's were the legal manifestation of stakeholder theory.[24] They allowed, and in some states required, directors to take account of the interests of stakeholders beyond their shareholders. They were in part a response to the takeover wave in the US of the 1980s.[25]

In practice, there is much scepticism as to the degree of protection that constituency statutes afford stakeholders. Part of the problem appears to be a reluctance of courts to interpret statutes in anything other than a shareholder primacy context.[26] Another is that stakeholders have no means of seeking redress if directors fail to take their interests into account.[27] Combined with concerns about the practicality or desirability of businesses adopting stakeholder practices,[28]

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[20] Nestle has a particularly mixed track record, which also involves a general criticism of processed-food industry business models that advocate health and wellbeing while "deliberately addicting customers to high content of sugar, salt and fat in their main business". See for example: Crane, Andrew, Palazzo, Guido, Spence, Laura J, and Matten, Dirk. "Contesting the Value of "Creating Shared Value"." *California Management Review* 56.2 (2014): 130-53.

[21] Edward Freeman (1984), *Strategic Management: A Stakeholder Approach,* Boston: Pitman/Ballinger.

[22] Freeman, R. Edward, Wicks, Andrew C, and Parmar, Bidhan. "Stakeholder Theory and "The Corporate Objective Revisited"." Organization Science (Providence, R.I.) 15.3 (2004): 364-69.

[23] Andrew Keay (2011), "Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado about Little?, *European Business Law Review,* 22, 1-49.

[24] Ronn Davids (1995), "Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?" *Columbia Journal of Law and Social Problems,* 28, 145-147.

[25] Jonathan Springer (1999) "Corporate Constituency Statutes: Hollow Hopes and False Fears" *Annual Survey of American Law,* 85.

[26] Anthony Bisconti (2009), "The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in Revlon Land" *Loyola of Los Angeles Law Review*, 42._

[27] Jonathan Springer (1999), "Corporate Constituency Statutes: Hollow Hopes and False Fears", *Annual Survey of American Law* 85 at 108.

[28] Lucian Bebchuk and Roberto Tallarita (2020), "The Illusory Promise of Stakeholder Capitalism", *Cornell Law Review,* 106, 91-177.

some observers conclude that "constituency statutes failed to deliver the benefits to stakeholders that were promised or hoped for in the push for the adoption of these statutes."[29]

Another legal form that originated in the US which promotes stakeholder interests beyond shareholders is the benefit corporation (also known as the public benefit corporation). Benefit corporations are formally established under state statutes that require for-profit entities to pursue a dual mission of profits and social purpose.[30] Maryland was the first state to adopt a benefit corporation law in 2010 and 38 states including the District of Columbia have now passed one.

Critics claim that benefit corporations will be used for "purpose washing"[31] and that new legislation is unnecessary as existing legislation permits directors sufficient latitude.[32] There are very few empirical studies of benefit corporations, largely reflecting the paucity of data available on them. One study finds that there is much inactivity amongst benefit corporations, and many are not delivering any social or environmental benefits.[33] Another concludes that, contrary to concerns that benefit corporations will fail to attract investors, they are receiving significant amounts of investments largely because they are concentrated in consumer-facing sectors where their benefit status is a driver of sufficient financial returns to justify investments.[34] If this is the case then benefit corporations will be restricted to companies for which it is a form of enlightened shareholder value, conferring superior financial returns as well as public benefits.

Attempts to promote stakeholder interests through either enlightened shareholder value or stakeholder-oriented legislation have arguably therefore failed to deliver much variation from conventional shareholder primacy. Empowering directors to adopt practices that incorporate the interests of parties beyond shareholders does not appear to be sufficient on its own. This should come as no surprise when authority to seek redress for failures on the part of directors resides in each case solely with shareholders. None of them incorporate accountability to any other party and, even if they did, then there is little basis on which courts could arbitrate between the interests of the different parties. Ultimately, except in the most egregious cases, directors are likely to be granted discretion in exercising business judgment.

Overall, it is unlikely that any of the current forms of corporation will address the long-term, systemic challenges that firms are now expected to rise to: those of restoring and enhancing natural and social capital in the environments that they operate in. This is because there is a lack of alignment between management theory and the challenges we face: current versions of shareholderism and stakeholder theory ask companies to respond to system-level problems, deploying the assets of individual companies and implementing corporate-level strategies.

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[29] Lucian Bebchuk, Kobi Kastiel and Roberto Tallarita (2020), "For Whom Corporate Leaders Bargain", SSRN Working Draft, 367155.
[30] Shannon Vaughan and Shelly Arsneault (2018), "The Public Benefit of Benefit Corporations", *Political Science & Politics,* 51, 54-60.
[31] Kennan El Khatib (2015), "The Harms of the Benefit Corporation", *American University Law Review,* 65, 151.
[32] Joan MacLeod Heminway (2018), "Let's Not Give Up on Traditional For-Profit Corporations for Sustainable Social Enterprise", *University of Missouri-Kansas City Law Review,* 86, 779.
[33] Ellen Berrey (2018), "Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations", *Transactions: The Tennessee Journal of Business Law*, 20, 21-114.
[34] Michael Dorff, James Hicks and Steven Davidoff Solomon (2021), "The Future or Fancy? An Empirical Study of Public Benefit Corporations", *Harvard Business Law Review,* 11, 114-158.

The mismatch makes much of what companies have described and undertaken as their corporate social responsibility (CSR) work largely misplaced, ineffective and even counterproductive. CSR area is plagued with a chronic lack of accountability, and a lack of recognition of the inescapable trade-offs involved between making investments to benefit one stakeholder often at the expense of, or overlooking the needs of, another. The well documented CSR disasters of Coca Cola and Nike illustrate the point.[35] As Bebchuk and Tallarita (2020)'s argue, given current incentive systems and corporate legal frameworks, "corporate leaders (both directors and CEOs) have strong incentives to enhance shareholder value but little incentive to treat stakeholder interests as an independent end."[36]

2.4 Corporate Purpose Reimagined

The last decade has witnessed a re-emergence of the debate around purpose in the for-profit firm. What has motivated this has been a realization and concern about the problems created, as well as not addressed, by a pre-occupation with corporate profits. These problems relate particularly to the environment, inequality, social exclusion, and the spate of corporate failures and scandals that have blighted business over the past two decades.

The initial response has been in essence a refocusing of purpose away from its raw shareholder primacy form to enlightened shareholder value, seeing the potential for both enhanced financial performance, and environmental and social benefits.[37] But a recent review observes that we are seeing more fundamental changes in the purpose-debate. In particular, there is a pronounced divergence in the ethical commitments implied by the various conceptions of responsible business. On one hand, there remains a goal-based perspective on corporate purpose, while on the other hand, a duty-based conception of purpose is emerging too. The latter explicitly links purpose in the for-profit firm to wider societal responsibilities.[38] Shareholderism is a goal-based, instrumental theory, while stakeholderism, and the more recent "purposeful company" and "system stewardship" notions represent a shift towards a duty-based view of the firm.

Under the duty-based view, we look to corporations, first, to use their distinctive advantages of separate legal form, perpetual existence, limited liability, and capital raising to help address the problems we face as individuals, societies, and the nature world. Second, we look to corporations to take real responsibility for their people and communities by strengthening our institutions.[39] Third, we look to them to do so in a way that is commercially viable, financially sustainable, and profitable. So, the British Academy Future of the Corporation programme defines the purpose of business as being "to produce profitable solutions to the problems of people and planet."[40]

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[35] Kenneth P. Plucker (2021) The Trillion-Dollar Fantasy: Linking ESG investing to planetary impact. *Institutional Investor*. Accessed on 14 September, 2021 at https://www.institutionalinvestor.com/article/b1tkr826880fy2/The-Trillion-Dollar-Fantasy

[36] Lucien Bebchuk and Roberto Tallarita (2020), The illusory promise of stakeholder governance. *Cornell Law Review*.

[37] Several recent pronouncements regarding corporate purpose can be interpreted in this way, for example, the Business Roundtable (2019). "Statement on the Purpose of a Corporation", 19 August 2019.

[38] George, Gerard, Haas, Martine R, McGahan, Anita M, Schillebeeckx, Simon J. D, and Tracey, Paul. "Purpose in the For-Profit Firm: A Review and Framework for Management Research." *Journal of Management* (2021): Journal of Management, 2021.

[39] Rebecca Henderson(2021), *Reimagining capitalism in a world on fire*. Random House.

[40] British Academy (2018), *Reforming Business for the 21st Century: A Framework for the Future of the Corporation,* London: British Academy; British Academy (2019), *Principles for Purposeful Business,* London:

However, there is a fourth part to the definition which is particularly critical to this paper and that is that companies should "not profit from producing problems". This highlights the issue of the definition of a profit. At present, the reigning economic notion of profitability (i.e. the return-on-equity ratio) is simply the net financial earnings of a company over and above the equity it employs.[41] It takes no account of whether in the process a company profits at the expense of other parties through, for example, making employees or suppliers redundant or imposing negative externalities on third parties, such as communities and the natural world.

The importance of this "system stewardship" notion of purpose is that it provides a natural way of addressing the problems of accountability and enforcement that underpin the limitations of ESV and stakeholder theories mentioned above. So long as accountability and enforceability relate to assessments of the benefits and detriments suffered by different parties then they involve making incalculable interpersonal comparisons. How for example does one trade-off the employment benefits that derive from expansion of a company's activities against the environmental costs that might be incurred in the process? Answering this involves undertaking incommensurable measurements.

If on the other hand one poses the question of the extent to which the company has profited from not avoiding or offsetting the environmental damage it has created, then one has the basis for determining the extent to which it is profiting from producing problems. In other words, the emphasis shifts from highly subjective valuations of benefits and detriments incurred by different parties to the costs of remedying problems. This strengthens the degree to which the firm can be held accountable for its activities and the enforceability of remedies by courts.

It is this which emphasizes the link between accounting and the degree to which it is feasible or credible to promote responsible business and a focus of companies on the interests of stakeholders other than their shareholders. It does not come from simply empowering or requiring directors to take account of their interests potentially at the expense of shareholder profits but by defining shareholder profits so that they do not arise where companies fail to take stakeholder interests into account. In that way there is an alignment not a conflict between profit and responsible business and incentive compatibility between the two that has been missing from the ways of measuring performance that have been suggested to date. And it is to this which we now turn in the third part of this article.

3. Four Forms of Accounting

There are four forms of accounting that are widely discussed in the context of the different categories of responsible business. These are fair value accounting (for shareholderism), narrative reporting based on non-financial performance measurement (EVS), social and environmental accounting (stakeholderism) and cost accounting (corporate purpose as system stewarsdhip).

British Academy; and British Academy (2021), *Policy and Practice of Purposeful Business: The Final Report of the Future of the Corporation Programme,* London: British Academy.

[41]Jonathan Levy (2014) demonstrates how the notion of profit and profitability evolved over the last two centuries of Western capitalism. Interestingly, Return on Equity (ROE) emerged as the accompanying performance-measurement mechanism of the financial conglomerates and the increasingly financialized, asset-light, "intangible" corporation. Forms of capitalism where manufacturing still reigns deploy return on capital employed (ROCE), or return on investment (ROI), taking account of physical – not just financial- capital. None of these notions of profit take account of externalities imposed by the firm on others.

As Levy (2014) argues, "profit has a history as contingent and as eventful as any other […] The history of profit is a history of power." Looking at profit and other measures of firm performance through a historical lens, accounting appears to be in flux, corresponding to the social, economic, and institutional demands of its day. Accounting historians demonstrated that the definition of profit is mutually constitutive of (and constituted by) the economic context in which it is calculated. At stake is the redistribution of wealth created by the modern corporation between its shareholders, managers, and other stakeholders.

That Western capitalism sought to transcend the industrial crisis of the 1970s through financial profit-making is by now a well-known story. But the shift entailed not only a purging of fixed capital, and a subsequent reallocation of capital to financial activity, it also entailed an utterly different definition of profit. The traditional historic-cost-based profit metric – return on capital invested - which was suited to manufacturing industry until its decline from the late 1970s due to competition from low-cost economies and inadequate industrial policy-support, became obsolete. By the turn of the twenty-first century, profit was increasingly computed as a rate of return on equity (ROE) according to new "fair value accounting" (also known as "mark-to-market") criteria. This financialization of accounting went hand in hand with the rise of narrative reporting. History records that, whenever measurement reaches its practical limits, narratives rush in to fill the resulting vacuum.[42]

3.1 Fair Value Accounting

In 2006, the Financial Accounting Standards Board (FASB) defined fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'[43] Mark to market accounting challenged historic cost accounting and signified a new era of capitalism.

Historic cost accounting emerged in the wake of the industrial depression of the 1890s and the resulting Great Merger Movement of 1895–1904. In pursuit of the full integration of the firm's internal operations and external transactions into a singular accounting "entity", accounting adopted the "entity" concept and historical cost accounting emerged to value assets on their balance sheet from historical book values. In large manufacturing firms taking the multidivisional form, depreciation of fixed assets (physical capital) loomed large. Post-war central headquarters employed ROI metrics to hold disparate operating divisions to account. ROI stretched the timespan of profit as it was calculated (in the case of companies that were willing to earn an average satisfactory return) over the entire business cycle.[44]

One of the founding members of the Securities and Exchange Commission, Robert Healy was a particularly strong proponent of the SEC's insistence on historic-cost accounting, based on his experience of leading the Federal Trade Commission's investigation into manipulation by public utilities. Write-ups of assets above historic cost were commonplace in the US in the 1920's but were in general modest in scope, except in utilities where they were extensive and substantial.[45] This practice went under the name of "proprietary" theory. The idea was that

[42] Chahed, Yasmine. "Words and Numbers: Financialization and Accounting Standard Setting in the United Kingdom." *Contemporary Accounting Research* 38.1 (2021): 302-37.
[43] Financial Accounting Standards Board (2006), *Statement of Financial Accounting Standards,* No. 157.
[44] Kaplan (1984)
[45] Robert Walker (1992) "The SEC's Ban on Upward Asset Revaluations and the Disclosure of Current Values", *Abacus*, 28, 3-35.

corporate accounting should reflect value creation considering the corporation's proprietary owners—its stockholders. Managerial "entity" historical cost accounting triumphed instead, with most assets on twentieth-century industrial corporations' balance sheets being non-financial assets: factories and machinery. Therefore, during this period, "management [saw] itself as responsible to stockholders, employees, customers, the general public, and perhaps most important the firm itself as an institution".[46] The "soulful corporation" was born.

Historic-cost accounting remained in force until the 1970s when rising inflation prompted an acceptance of current-cost accounting by the SEC.[47] Two additional events then promoted the move to fair value accounting and mark-to-market in the 1980's and 1990's. The first was the Savings and Loans Crisis, which revealed the deficiencies of historic cost during periods of significant loan losses, and the second was the growth of derivative markets, which emphasized the significance of market valuations. The International Accounting Standards Committee (IASC) included fair value in various accounting standards relating to leases, property, and business combinations from the end of the 1970s onwards.

With the move from historic cost to fair value and mark-to-market, the pendulum swung back to proprietary theory. Fair value seemed fit for the historic context: as financial value replaced historic-cost accounting and return-on-equity replaced return-on-investment, accounts began to narrate "market histories of finance capital".[48] With ongoing deindustrialization and the simultaneous rise of takeover markets in the U.S. and U.K., capital took increasingly financial forms, and the "profit maximizing" corporation was born. Short-term time pressure pushed the non-profit out of the for-profit firms, replaced assets with outsourcing, and put an end to the era of "soulful" corporations. With asset-light business models and securitization, it became possible to generate substantial earnings with little fixed capital investment.

This shift was in line with economists' formulations of valuation as described in Irving Fisher's translation of accounting concepts of profit and capital into income and wealth,[49] and John Hick's notion of income as being the maximum amount someone can consume during a period without being worse off at the end of it.[50] According to the new academic "agency theory," inspired by financial economics, a corporation was merely a "nexus of contracts" among self-interested parties. Managers were not "public trustees." Rather, they existed to pursue the short-term maximization" of "shareholder value."

Mark-to-market directly challenged historical cost accounting by saying that asset values should be updated to reflect, "the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction." But an actual market transaction did not have to happen. If corporations had their own stocks - and / or other securities - on their own balance sheet, these could be updated to reflect going market valuations. If historical-cost accounting was (as claimed by its opponents) simply the manager's self-interested history of capital, prone to profit smoothing and the sentimental treatment of profit-seeking capital as communal wealth, mark-to-market was said to offer a

[46] Carl Kaysen (1957), "The Social Significance of the Modern Corporation." *American Economic Review*, 47, 311–319.
[47] Stephen Zeff (2007), "The SEC Rules Historic Cost Accounting: 1934 to the 1970s" *Accounting and Business Research*, Special Issue: International Accounting Policy Forum, 48–62.
[48] Levy (2014)
[49] Irving Fisher (1907), *The Nature of Capital and Income*, New York, Augustus M. Kelley.
[50] John Hicks (1946), *Value and Capital*, Oxford, Clarendon Press.

more transparent financial snapshot. ROE became a market history of finance capital, compressed into a single price that reflected all known information about the future.

The shift has had a profound effect on management. Instead of being concerned with the resourcing of the long-term productive potential of the firm, management's focus moved to the short-term consumption that can be derived from earnings creation. In line with shareholder primacy and the Friedman Doctrine, management objectives are – to this day – primarily measured in terms of enhancing shareholder value. Fair value and shareholder primacy are therefore natural bedfellows and the emergence of the two in tandem was no coincidence.

3.2 Environmental, Social and Governance (ESG) Reporting

Agency theory, as a basis of accounting missed several aspects of the realities of managing a for-profit firm. First, with its distaste for managerial "slack" and the "soulful" corporation, it focussed the attention of accountants (and ultimately, of investors and managers) on short-term financial returns. Omitted from the theory was the role of knowledge and innovation as a source of value creation in the firm.[51] The theory also missed a host of intangible options that entrepreneurial firms could exercise to enhance value. These include more imaginative marketing, product and process improvements, training and motivating employees, and improved quality and maintenance policies. Measuring progress on these non-financial aspects of business required the rise of a new kind of accounting: one that added non-financial metrics to financial performance measurement. The balanced scorecard was born. [52]

The balanced scorecard provides an internal, strategic view of a firm's performance. However, in the wake of the corporate disasters of the late 1990s and early 2000s, investor demand for seeing the firms as if "through the eyes of management" rose. Regulators and standard setters around the globe have placed increased emphasis on explanatory statements as an integral part of corporate reporting to capital markets (SEC 2003; CICA 2004; EC 2004; ASB 2006; IASB 2010)[53]. Guideline setters came forward to propose that companies voluntarily disclose non-financial aspects of their operations ranging from risk management through their treatment of their employees to their other actions related to corporate social responsibility (CSR).

According to a recent review, CSR reporting differs from traditional financial reporting in a number of important ways, including: i) the larger potential audience for CSR reporting; ii) the broad range of topics covered by CSR; iii) the multiplicity of objectives addressed by CSR reflecting the different preferences of stakeholders; iv) the non-monetary basis of much CSR measurement; v) the largely voluntary disclosure of CSR (although this is changing rapidly in many jurisdictions); vi) the lack of association of CSR with a firm's strategy; and vii) the importance of externalities in CSR activities and reporting.[54]

It is in this context of enhanced narrative reporting and the CSR movement that the disclosure of Environmental, Social and Governance (ESG) factors was first proposed in a report produced by the U.N. Global Compact in 2004.[55] It began by stating that "a better inclusion of

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[51] Kaplan (1984)
[52] Robert S Kaplan. "Innovation Action Research: Creating New Management Theory and Practice." *Journal of Management Accounting Research* 10 (1998): 89.
[53] Chahed (2021)
[54] Christensen, H. B., Hail, L., & Leuz, C. (2021). Adoption of CSR and Sustainability Reporting Standards - Economic Analysis and Review (ECGI Working Paper Series in Finance No. 623).
[55] The U.N. Global Compact (2004), *Who Cares Wins: Connecting Financial Markets to a Changing World*

environmental, social and corporate governance (ESG) factors in investment decisions will ultimately contribute to more stable and predictable markets, which is in the interest of all market actors".

The original objectives of ESG were therefore the inclusion of factors beyond financial performance that were material to the stability and functioning of markets. It followed the principles of "Triple Bottom Line" accounting for environmental and social as well as financial performance proposed by John Elkington[56] to capture the concept of sustainable development defined by the U.N.'s Bruntland Commission in 1987.[57]

The two decades since the first Global Compact report have seen the emergence of a large industry devoted to the determination and narrative reporting of ESG factors and other CSR activities. The supporting accounting technology has developed much along the lines of the concept of Enlightened Shareholder Value in two respects. First, it seeks to incorporate factors beyond financial performance and, second, it was established by the investment industry to enhance the functioning of markets. It is therefore perceived as contributing to the performance and resilience of financial investments through incorporating the impact of business on other parties, namely the environment and society.

ESG operates in parallel to existing systems of financial accounting and reporting, supplementing them with additional information relevant to financial performance. It does not seek to amend or replace existing systems of accounting. Furthermore, ESG-related activities are generally seen as consistent, not in conflict, with the financial performance of firms, creating benefits for both shareholders and other stakeholders. The ESG agenda is in other words a supplement to shareholder-value maximization and fair value accounting, not an alternative to them.

This is not to say that it is impossible to determine ESG factors that are associated with the intrinsic interests of stakeholders *per se* rather than through the lens of investors and derivative of those of financial markets. Indeed, that is what some parties, such as the Global Reporting Initiative (GRI) have advocated - reporting in relation to all stakeholder not just financial materiality. To influence business and investor conduct, ESG needs to be supplemented with (1) an honest discussion of the trade-offs implicated by the plurality of "stakeholder view"; (2) true accountability and institutional (legal) change to create incentives for managers to protect stakeholders, and (3) a single unit of account by which impacts on different parties can be measured and compared.

3.3 Social and environmental accounting (SEA)

Accounting scholars advocating pluralistic stakeholder-accountability view large corporations as quasi-public institutions, and seek to promote a more open, transparent and democratic society.[58] They introduce the notion of 'plural accountability' and assume that a corresponding accounting practice – which they call 'social and environmental accounting', SEA - can create transparency and informed public dialogue and debate through civic institutions. Information

[56] John Elkington (1997), *Cannibals with Forks: The Triple Bottom Line of 21st Century Business,* Oxford: Capstone.
[57] World Commission on Environment and Development (1987), *Our Common Future*, Oxford: Oxford University Press.

[58] Brown and Fraser (2006)

disclosure is viewed as a vital pre-requisite for informed participation.[59] Greater access to SEA information is viewed as an essential part of increasing transparency surrounding corporate activity and its consequences for stakeholders. Accounting thereby helps to create new visibilities and facilitates discussion and debate among interested parties.

The existence of techniques and data for evaluating projects and firms in a uni-dimensional way tends to encourage uni-dimensional decision-making.[60] Thus, a particular form of accounting may grasp an aspect of "the reality" of the organization, but (due to its omissions and blind spots) can have a disturbing effect on others. Before ROE and FVA reigned supreme, and especially during the de-industrialization in the U.S. and U.K, multiple, competing notions of what constitutes a profitable factory were heard. Historians show us the diverse views of profitability that were involved in these debates - even court cases and industrial action negotiations when disgruntled unions sued or walked out on management for their intention to close an "unprofitable" plant or an "uneconomic" pit that for them appeared to be viable.

Chief Justice George Edwards, presiding over the case of The United Steel Workers of America v. The United States Steel Corporation (1980) - concerning the closing of two Youngstown, Ohio, steel mills, which were deemed unprofitable by management and profitable by the union - noted that profit was not an obvious, neutral, or timeless economic benchmark. Rather, it was a calculative practice open to interpretation. Edwards acknowledged that "with a different definition of profit," the "outcome of an accounting analysis could be made to be non-profitability."[61]

In a similar vein, SEA advocates argue that the decision regarding what constitutes an "economic" or profitable firm (be that a coal mine or a Silicon-valley giant) is underpinned by social and political choices, and that the accounting and economic principles used in actual decision-making capture only a small aspect of the wider socio-political decisions being faced. Therefore, SEA promotes dialogue among stakeholders. The challenge facing accountants is to develop processes that emphasize how accounting statements and insights should be regarded and used as elements of a conversation or dialogue, rather than as foundational claims asserting a particular kind of objectivity or "truth".[62] The aim is to open up conversations, not close them down with 'incontrovertible bottom lines.'[63] SEA proponents firmly reject the dominance of shareholders and capital markets, and assume that given accountability and transparency, stakeholders will respond by exercising the three Hirschmanian options: exit, voice or loyalty.

The technology of SEA would include third-party "shadow accounts" and external environmental (and / or social) audits. In practice, plural accountability and SEA has not delivered its promise, and many argue, even backfired. Radical change has not occurred in the formal incentives surrounding corporations and managers. As Bebchuk and Tallarita observe, SEA advocates largely failed to pay attention to legal constraints that preclude many companies from approaching stakeholder interests as an independent end. In the absence of the legal and

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[59] Brown JA. 2000. Competing ideologies in the accounting and industrial relations environment. *British Accounting Review* 32: 43–75.
[60] Morgan G. 1988. Accounting as reality construction: towards a new epistemology for accounting practice. *Accounting, Organizations and Society* 13(5): 477–485.
[61] Levy (2014)
[62] Morgan (1986)
[63] Gordon Boyce. "Public Discourse and Decision Making Exploring Possibilities for Financial, Social and Environmental Accounting." Accounting, Auditing & Accountability Journal 13.1 (2000): 27.

institutional frameworks that would make alternative accounts count, instead of occupying centre stage, social and environmental issues remain 'appendages which drop off when the going gets tough'.[64] The focus is still on what is value adding for companies. Business still sets the agenda, and in practice, SEA has been submerged into narrative reporting – ESG and CSR reporting.

It is for this reason that pluralistic stakeholder-accountability theorists are dismissive of much current ESG and CSR practice. In addition, these practices are criticized for their poor quality (e.g. in terms of their incompleteness, selective nature and inadequate audit) and managerialist focus, offering little, if anything, in the way of real accountability.

The Impact Weighted Accounts Project at Harvard Business School is seeking to redress this situation by taking pluralistic accountability seriously and by attaching monetary valuations to a company's positive and negative impacts on employees, customers, the environment, and society.[65] Its methodology focuses on determining the impact of firms on humans, societies and the environment, deriving monetary values from actual or imputed prices and discounting them back to the present. The Project effectively aims at the aspirations of pluralistic stakeholder accountability: correcting the distortions that exist from an exclusive focus on financial and material capital.

However, it raises significant practical and conceptual issues, analogous to those that afflict stakeholder theory. The projection of benefits, detriments, prices, shadow and imputed prices associated with non-material assets is often a formidable task and the determination of appropriate rates at which to discount benefits and costs back to the present equally demanding. At present, the Impact Weighted Accounts Project leaves measurement largely unassured and produced at the discretion of corporations. It states that "our aim is that companies measure and disclose impact through impact-weighted accounts that eventually become standard management and governance tools" but the degree of subjectivity associated with this is not in general what is expected or deemed acceptable of corporate accounts.

In addition to the methodological challenges, there are also significant conceptual issues. While in principle stakeholder theory should address the instrumental deficiency of enlightened shareholder value of viewing the interests of stakeholders through the eyes of shareholders, Impact Weighted Accounts are still instrumental in taking an anthropocentric view of capital measurement. While that is reasonable in relation to human capital, it can be highly problematic for natural capital. Measuring the benefits that humans derive from nature does not ensure or promote the preservation or enhancement of nature; indeed, valuations of natural assets may increase as the state of nature of declines if prices rise in response to its growing scarcity. Similarly, in reporting net benefits, Impact Weighted Accounts do not ensure the protection of stakeholders where the benefits to one party, for example increased employment, outweigh the costs to another, for example environmental degradation.

Alongside the limitations of the shareholder primacy, enlightened shareholder value and stakeholder theories of responsible business, there are therefore corresponding deficiencies of their forms of accounting – fair value, narrative reporting, and plural-accountability notions of

[64] Brown and Fraser (2006)

[65] George Serafeim, Robert Zochowski and Jennifer Downing (2019), *Impact-Weighted Financial Accounts: The Missing Piece for an Impact Economy*, White Paper, Harvard Business School, Boston, MA.

SEA. To address them we return to the objective behind what accounting is seeking to achieve regarding responsible business in our time, and to a corresponding form of accounting.

3.4 Accounting for Corporate Purpose as System Stewardship: Maintenance Cost Accounting

Stakeholderism has proven to be a dead-end street. Its benefits may remain illusory[66], its real impacts are still unaccounted for, and investors and others are slowly recognizing that ESG accounting (and ESG investment), as currently practiced, will not likely lead to financial outperformance, nor is it mostly concerned with planetary impact.[67] As Bebchuk and Tallarita (2020) argue, acceptance of stakeholderism could well have imposed major costs. By making corporate leaders less accountable, CSR actions undertaken for the sake of greenwashing or whitewashing could have genuinely hurt firm performance, reducing the economic pie available to shareholders, and deserving stakeholders. In addition, and importantly, by raising illusory hopes that corporate leaders would on their own protect stakeholders, a general acceptance of stakeholderism may well have impeded and delayed reforms that could bring real, meaningful protection to stakeholders.

In this section we outline the contours of "system stewardship accounting" that would create real accountability around corporate stewardship, and visibility around profits earned at the detriments of stakeholders, versus income that a firm has earned after redressing negative externalities – sustainable profit.

The principles of "system stewardship accounting" are as follows:

1. *Stewardship*

The accounting we propose is incumbent upon businesses to design products and services with the realization that humans are environmental stewards of the planet and have an obligation to consider the welfare of future generations[68]. This represents a radical departure from the traditional profit-maximizing view of corporate purpose. [69] At the very least, this accounting is predicated on a sense of urgency to reduce environmental externalities and to cost the remainder correctly to incentivize environmentally conscious design.

2. *Materiality*

Barker and Mayer (2021) argue that sustainability accounting is best addressed through regarding ecological materiality as analogous to financial materiality in the sense that something is ecologically material if its omission would affect users' understanding of a company's impact on natural capital.[70] This suggests that there is merit in taking a precautionary approach to the maintenance of natural capital as an end in itself. It focuses on 'critical natural capital' with no substitute. Similarly, stewardship accounting must encompass notions of ecological and social materiality by considering a company's impact not only on critical natural, but critical social capital, too.

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[66] Bebchuk and Tallarita (2021)
[67] Plucker (2021)
[68] McDonough, W., & Braungart, M. 2002. Cradle to cradle: Remaking the way we make things. New York, NY:North Point Press.
[69] George et al. (2021)
[70] Richard Barker and Colin Mayer (2021), "Seeing Double: Financial Accounting and Reporting from the Perspectives of Financial Materiality and Ecological Materiality", Working Paper, Said Business School, University of Oxford.

3. A (maintenance) costing approach

It is not appropriate to produce a balance sheet of a company's natural / social assets because a company does not have exclusive ownership of the "earth's services" and social capital on which it depends. Instead, Barker and Mayer (2021) advocate the use of an income approach in which account is taken of the state of natural capital and the cost of maintaining it over the relevant period. This is therefore a maintenance cost approach rather than the valuation one of Impact Weighted Accounting. Our form of sustainability accounting differs from those mentioned before: while CSR / ESG are examples of voluntary and ad hoc narrative reporting, the more standardized Impact Weighted Accounting fails to take an ecological stewardship as against an anthropocentric perspective.

Cost accounting dates to the 14th century with the emergence of English, Flemish, German and Italian commerce. It became widespread in England at the end of 15th century when woollen manufacturers, resentful of the restrictions imposed by the guilds, established independent industrial communities in country villages and developed records of their costs to assist with their management.[71] The main impetus for its adoption came during the Industrial Revolution with the growth of engineering, coal and textile industries and requirements for accounting for inventories of raw materials, depreciation and obsolescence of plant equipment, and the transfer of product through successive manufacturing processes.

At the end of the 19th century, the operating ratio, relating income and outgoings to internal production costs, emerged as a focus of attention of the newly emerging industrialists in the US, such as Andrew Carnegie and John D. Rockefeller.[72] Carnegie applied the operating ratio to railroads in the form of cost per ton-miles and to steel as cost per ton. He lectured his managers: "show me your costs sheets. It is more interesting to know how well and how cheaply you have done this thing than how much money you have made, because the one is a temporary result, due possibly to special conditions of trade, but the other means a permanency that will go on with the steel works as long as they last."[73]

Cost accounting emerged and evolved to meet the changing needs of business and society over time.[74] And it needs to evolve again in this decade to reflect the requirement for responsible businesses to account for the maintenance costs of managing their growing impacts on the environment and society as well as their customers. The approach of maintenance cost accounting described here – and in more detail, in Barker and Mayer (2021) - provides a practical resolution to the limitations and inadequacies of other accounting systems grappling with externalities that companies impose on society and the natural world. It departs from the extrinsic form of accounting systems that view the world from the perspective of shareholders, or humans in the case of nature, rather than those directly affected by the firm's activities, and it avoids the problem of determining subjective and unreliable valuations.

4. Boundaries

What is involved in adapting maintenance cost accounting to incorporate externalities is a recognition that the determination of the costs should no longer be (and arguably should never

[71] Paul Garner (1947), "Historical Development of Cost Accounting", *The Accounting Review,* 22, 385-389.
[72] Jonathan Levy (2014), "Accounting for Profit and the History of Capital", *Critical Historical Studies*, 1, 171-214.
[73] Harold Livesay (2007), *Andrew Carnegie and the Rise of Big Business*, New York: Pearson Longman, p.112.
[74] Kaplan (1984)

have been) defined by the legal boundaries, ownership, or contracts of firms. Ruth Hines in a famous article in 1988[75] wrote that "Financial accounting controversies are controversies about how to define the organization. For example, what should "assets" and "liabilities" include / exclude." These are societal debates about the boundaries of the firm. "Once the organization becomes accountable for something", Hines continued, "we must account for it, sooner or later." The question that the new "purpose as system stewardship" logic raises is twofold:

The first question is: Should negative externalities be counted as within the boundaries of the firm? The answer, in this paper, is: Yes. However, according to the sociology of accounting, the answer to this question will not be given by accountants (or academics) alone. As Hines cautioned us – accountants are no revolutionaries, neither are we. Or rather, "we could not do something as big as that on our own. Social change… we could not change the picture as radically as that and get away with it. Bu the day will come, when people so clearly "see" [negative externalities] as part of the organization, that we will have to include it in the picture". (Hines, 1988).

Whether the day has come and in relation to which externalities, is an empirical question. We believe we are closer to the day when society clearly "sees" carbon emissions as part of the firm – and we are further from the day when we include externalities imposed on social capital (communities and employees).
The second question is: Once a negative externality (e.g. carbon emission) is "seen "as within the boundary of the firm, how could it be "measured"?

5. *Measurement*

The fourth part of the definition of corporate purpose as system stewardship in section 2.4 was that a company should not profit from producing problems for either people or planet, irrespective of whether they reside within the legal boundaries of the firm. In other words, companies should avoid, rectify, or remedy the detriments they inflict and should incur – and record the costs from so doing. Where they fail to do so they are in effect failing to maintain assets on which they impact and should incur an equivalent maintenance or depreciation charge.[76]

But purpose as system stewardship is not just about not profiting from detriments but is also about producing profitable solutions to problems of people and planet. The delivery of those solutions should be resourced both in the form of operating expenditures and capital investments whose benefits in solving problems extend over more than one period. Those investments are made in human, social and natural as well as material and financial assets. Maintenance in those cases is not sufficient but instead the firm has to demonstrate enhancement. Profits are diminished in relation to how they are currently reported where detriments need to be remedied and would otherwise be earned at the expense of other stakeholders but increased where companies make investments in their stakeholders that are otherwise reported as operating instead of capital expenditures.

[75] Hines, Ruth D. "Financial Accounting: In Communicating Reality, We Construct Reality." *Accounting, Organizations and Society* 13.3 (1988): 251-61.
[76] Clara Barby et al. (2021), "Measuring Purpose: An Integrated Framework", Said Business School and SSRN, Working Paper, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3771892

Cost accounting therefore promises the measurement framework for putting purpose into practice.[77] It identifies the positive benefits a company promises to deliver in terms of problem solving and the negative detriments from which it will not profit. It establishes the operating and investment costs associated with delivering purpose and derives a measure of profit from doing so.

6. *Standard setting – challenges and complexities*

As for elaborating and standardizing the "system stewardship" accounting practices, the Ramanna-framework[78] offers a helpful start as it enunciates three requisite criteria that need to be met in order to internalize certain externalities into the firm's decisions: 1) Mitigating the firm's information advantages (c.f. stakeholder accounting's "seeing through the eyes of management" criterion) 2) Reporting both stocks and flows in the measures of account 3) Agreeing on a due process to match across periods the actions of firms and the outcomes of those actions.

The complexities of the standard setting process will likely involve the following: (1) Competing stakeholders may tug a single set of reports in different directions; (2) Institutional work is needed to ensure verifiability, conservatism and enforcement (3) In order to facilitate accountability for carbon emissions, a carbon budget is necessary – but in case of facilitating accountability for other forms of natural capital (e.g. "earth services") and social capital we need to define the "ecological and social-capital budget" for each firm, as well. (4) Matching to future direct benefits requires a due process, which agrees on appropriate time horizons to account for impact. Some negative externalities that a firm imposes in the short run may turn into positive if it furthers innovation (c.f. Schumpeterian innovation) and higher-order organizations - such as local and national governments, future generations - take remedial actions. Disentangling a particular firm's role in system-level change is difficult. (5) Similarly, trade-offs exist between different stakeholders. Much of narrative reporting seemingly pandering to their needs has so far tended to overlook the ubiquity of situations that present trade-offs between the interests of some stakeholders and long-term shareholder value. We need a process to aggregate or balance the interests of different constituencies in the face of such trade-offs, not leaving this matter again to the discretion of corporate managers.

As current accounting stands, it will not be possible to do this without changing the Financial Accounting Standards governing what counts as an asset, or a liability, or a cost – hence this will have to take place in the realm of Standard Setting. Research indicates that social and environmental accounting has already tried to do this – and failed to deliver. We need to understand the roots of that failure – which are probably not so much to do with technique, but with managing the social and political processes of new accounting standard creation. As the accounting-sociologist Anthony Hopwood would have it: is the "accounting constellation" right for "system-stewardship accounting"?

7. *Accountability*

With incentives and notions of accountability unchanged, firms may respond to calls for system stewardship by window dressing which will be ultimately counterproductive and welfare

[77] Bruno Roche and Colin Mayer, eds. (2021), *Putting Purpose into Practice: The Economics of Mutuality*, Oxford: Oxford University Press.

[78] Ramanna, Karthik. "A Framework for Research on Corporate Accountability Reporting." Accounting Horizons 26, no. 2 (June 2013).

reducing. True accountability and institutional (including legal and widespread cultural) change are necessary to create incentives for managers to protect stakeholders. We have to underline the important tenet of system stewardship that emphasizes the need for managers to undertake the requisite institutional work. That is, managers (as "agents to the system"[79]) would have to participate in creating the necessary legal, governance and accounting changes involved in bringing about the next phase of capitalism that can respond to our 21st century challenges.

4. Discussion and Conclusions

This paper has described how forms of accounting relate to different concepts of responsible business (Table 1). It has pointed to four theories of responsible business as being prevalent at present – shareholder primacy, enlightened shareholder value (ESV), stakeholder theory, and system-stewardship as corporate purpose. Shareholder primacy remains the dominant paradigm, and the emergence of ESV has if anything strengthened its dominance by demonstrating how and to what extent the interests of other parties can and should be incorporated in it.

Stakeholder theory is widely discussed and promoted but, while it has now been advocated for four decades, the business transformation that might have been expected of it has not materialized. There are good reasons for this. While in principle it addresses the extrinsic and therefore somewhat self-serving nature of ESV, it does so in a form that is so embracing of every party as to be essentially unworkable. As is regularly reiterated, "accountability to everybody is accountability to nobody".[80] Though it might be retorted that "accountability to one body (i.e. shareholders) means nobody else counts", adoption of stakeholder theory in place of shareholder primacy involves switching from one extreme to another.

Instead, system stewardship as corporate purpose expects companies to define the interests they prioritize and to demonstrate a commitment in terms of their corporate governance to delivering them. In particular, the form of corporate purpose described here of "producing profitable solutions to problems of people and planet, not profiting from producing problems for either", promotes the precise identification of the nature and target of the problem solving in which responsible firms should be engaging.

Critical to the fulfilment of responsible business is how it is accounted for. Four forms of accounting are discussed that respectively underpin the four categories of responsible business – fair value accounting, narrative reporting, pluralistic accounting, and maintenance cost accounting. The emergence of fair value accounting reflected the deficiencies of historic cost accounting in an era of rising inflation, deindustrialization and financialization of corporate transactions. Its consequences have been to intensify some of the causes of its emergence, namely financial failures and financialization, and the promotion of short-term financial gain at the expense of the long-term and other objectives.

[79] Henderson, R., & Ramanna, K. (2015)

[80] See, for example, the Council of Institutional Investors Response to Business Roundtable Statement on Corporate Purpose, August 19, 2019, https://www.cii.org/aug19_brt_response

	Shareholder value maximization (aka shareholderism)	**Enlightened shareholder value (aka instrumental stakeholderism)**	**Stakeholder theory (aka Pluralistic stakeholderism)**	**Corporate purpose reimagined (system stewardship)**
Stewardship and accountability	To shareholders only	To shareholders primarily	To all stakeholders (defined and chosen at the discretion of managers, with no legal-institutional support for enforcement)	To all stakeholders (defined by external stakeholders, to be enforced by laws and accounting rules)
Ethical commitments	Goal-based view on purpose (instrumentalism)	Goal-based view on purpose (instrumentalism)	Duty-based view on purpose (essentialism)	Duty-based view on purpose (essentialism)
Purpose	Profit maximization	Profit maximization	Benefiting all stakeholders; Balancing stakeholder interests	Producing profitable solutions for problems of people and the planet, not profiting from producing detriments for either.
Theoretical foundations	Proprietary theory (Adam Smith); Agency theory (shareholder value primacy); Free market doctrine	Agency theory (shareholder value primacy);	Business ethics: pluralism	Business ethics: pluralism Institutional theory Economic history
Manager-evangelists	Jack Welch Business Roundtable (1997)	Business Roundtable (1981)	Jim Collins (e.g. *Built to Last*, 2001)	Larry Fink (*2018 Letter to CEOs: A sense of purpose*) Business Roundtable (2018)
Academic advocates	Friedman, Jensen, Fama	Porter and Kramer	Freeman	Mayer, Henderson
Management Practice example	Jack Welch at GE	Nestle (scandals)	Coca Cola, Nike (scandals)	Arcelor Mittal (TBC)
Role of government / institutions	Non-interventionism	Light legal intervention (a managerialist approach)	Light legal intervention (in theory, it is driven by “true accountability and pluralism”, in practice it is a still a managerialist approach)	Legal / accounting / government interventions are needed (TBD)
Accounting	Return on equity; Mark-to-market accounting (Fair value accounting)	Narrative reporting; Non-financial performance measurement	In theory: external SEA audits; shadow accounts. In practice: Impact Weighted Accounts	In theory: maintenance cost accounting In practice: TBD

Table 1. Summary of the four conceptualizations of the responsible firm

Narrative reporting (including management-accounting developments such as the balanced scorecard and external reporting under the banners of ESG and CSR) emerged as a way of trying to moderate the more extreme effects of a combination of shareholder primacy and fair value accounting. However, they constitute a form of performance measurement and supplementary reporting, not a reformulation of corporate financial accounting, nor do they propose any change to the definition of profit. They are still carrying the managerialist spirit of enlightened shareholder value in suggesting ways of incorporating the interests of the environment and society in a form that enhances rather than detracts from financial performance.

As an exception, the Impact Weighted Accounting project seeks to extend accounting beyond material and financial capital to include human and natural assets. It therefore provides the accounting base for stakeholder theory, seeking to monetize human and natural as well material and financial assets and liabilities. In addition to the formidable practical challenges of accomplishing this, it raises several conceptual concerns, not least the anthropocentric and therefore extrinsic view of monetizing natural assets.

The problem that has therefore emerged is that existing approaches have failed to create the legal, accounting, incentive and culture changes needed to the prime challenge of 21st century corporation: to act as system stewards. Instead, the paper points to the merits of returning to one of the most basic and oldest forms of accounting, namely (maintenance) cost accounting, in firstly achieving the objectives of sustainability accounting, and more generally those of responsible business of solving problems of some parties while not creating problems for others.

It does this by recognizing that the impacts, rather than the legal boundaries, of a firm should determine its responsibilities. Its costs should relate to avoidance of the negative externalities it inflicts on others as well as those required to produce its goods and services. Furthermore, it should account for the operating and capital expenditures needed to deliver positive problem-solving benefits as well as to avoid problem-creating detriments. In so doing, it determines the profits that are associated with and required to incentivize responsible business.

Nevertheless, challenges remain in the area of standardizing system-stewardship accounting, affording new opportunities for accounting and its practitioners. For system-stewardship accounting to influence business and investor conduct, we believe it is necessary to supplement it with (1) an honest discussion of the trade-offs implied by the plurality of stakeholders; (2) true accountability and institutional (legal) change to create incentives for managers to protect stakeholders, and (3) a single set of accounts – the "sustainable" income statement - by which impacts on different parties can be measured and compared.