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From Values to "Value"

From the Creation of the Value of Firms to Sustainable Growth

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Abstract

[Mella, par. 1-4] Strictly speaking, firms are considered as systems for the creation of economic and financial value for their shareholders, and their performance – profit and the value of capital – is measured by a coherent system of monetary values.

Nevertheless, if we do not limit our view to simply the shareholders but consider instead a vast group of stakeholders, we must then also broaden our notion of the production of sustainable value in order to include both the social value and the environmental value.

Thus a firm must set a system of objectives for itself which is centered on its sustainable growth, and must therefore tend toward a multi-dimensional growth that encompasses the economic, social and environmental dimensions.

[Gazzola, par. 5-10] This implies an intense social action based on transparency, the management of its reputation, a dialogue with the stakeholders, research and development, and knowledge management, all of which require adequate communication instruments.

On the basis of this, our work takes up the traditional idea of the social balance as an instrument for social interaction and social cost/benefit analysis in order to show that such an instrument can describe, comment on and sum up the firm's own behaviour aimed at sustainable growth.

In this sense the social balance, as far as it certifies the ethical profile of the firm, legitimizes the latter's social and environmental role, not only in structural terms but above all moral ones, in the eyes of the community of reference, emphasizes the link between firm and territory, and affirms the concept of the firm as an entity that, by pursuing its own prevailing interests, contributes to improving the quality of life of the members of the society in which it operates and that can, in all respects, represent a means for the creation of sustainable value.

1. The capitalistic firm as a system that produces values. The overall fitness

Despite the differing perspectives from which the firm can be viewed, I believe it is appropriate to introduce the basic thesis that considers the capitalistic firm, or *Business Value-Creating Organizations* (BVCO), as an autopoietic production, business and profit-oriented

organization (Mella, 2003)[1], whose fitness resides in its capability – or efficiency (Beer, 1981) – to produce adequate levels of economic and financial values (Mella, 2002)[2].

In this sense the capitalistic firm is:

1) a *productive* organization that transforms utility, since it carries out a *productive* transformation of factors (QF) into productions (QP);

2) a *business* organization, since it is preordained to develop an economic transformation of values, by selling its production, QP, in markets at prices, pP, at least equal to the unit average cost of production, cP; if it is preordained to supply its production without a price, or if it recovers only a share of the production cost, it is a *non-business* organization;

3) a *profit* organization: if the operating logic of the business organization is to achieve the maximum *economic efficiency* by seeking $\{[\max] (pP - cP) > 0\}$[3], then it becomes a profit organization; if, instead, the operating logic of its processes is to achieve $\{[\min] (pP - cP) > 0\}$, then it becomes a non-profit (not-for-profit) organization;

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[1] As an *autopoietic system* (Varela, 1979; 1981: 38; Uribe, 1981: p. 61; Vicari, 1991, Bednarz, 1988; Luhmann, 1995;) the firm *produces itself* by regenerating the network of processes and processors, searching for the metabolic and energy inputs in the environment which are useful for *autopoiesis* and fleeing from those which are damaging (Zeleny & Hufford, 1992; Mingers, 1994), in order to extend the length of the collective life for periods that go beyond the "life" of the components" (Maturana & Varela, 1980: 82; Zeleny, 1981: 2).). In this sense the *cognitive* activity is necessary for existential success. *An organization is a teleonomic system in that it maintains its own autopoiesis by carrying out cognitive processes aimed at giving significance to the* environmental stimuli, translating these into information that is structured in knowledge, and producing a reactive and proactive behaviour to search for the conditions that allow individuals to benefit, directly or indirectly, from the achievement of a common end that defines its teleology.

[2] The production of value occurs through a network of efficient processes - carried out by a structure of processors, or organs, or by networks of specialized organizations (Alter and Hage, 1993) - that produce cognition, metabolism and transformation supported by specific rules that define their stable equilibriums.
From a *cognitive* point of view the BVCOs are conscious cognitive systems (Walsh, 1995; Toffler, 1985) that present two characteristics:

1. they are *operationally closed* – in that the cognitive (and computational) processes derive from the cognitive interconnections among all the individuals that make up the organization (Maturana and Varela, 1980);
2. they are *structurally coupled* to the environment; through (and to the extent of) their own cognitive and computational resources they perceive disturbances as external stimuli, process these to form *representations of the external world*, and act (react or pro-act) to re-equilibrate the network of vital processes.

Form an operational point of view, when considered as autopoietic and teleological organizations, capitalistic firms can be interpreted as operating systems for efficient transformation that carry out five parallel transformations:

a. a *productive transformation* of factors into production; this is a transformation of utility, governed by productivity and by quality;
b. an *economic transformation* of costs and revenues into operating income; this is a transformation of value, governed by prices and therefore by the market;
c. a *financial transformation* of risks, which transforms capital into returns and guarantees the maintenance of its financial integrity;
d. an *entrepreneurial transformation* of information into strategies, which leads to a continual readjustment of the firm's strategic position (Prahalad & Bettis,1986; Harrison & St. John, 1998);
e. a *managerial* (organizational) *transformation* of strategies into actions of management control (Davenport, 1993; Lax & Sebenius, 1986).

[3] Distinguishing between unit variable (vc) and total fixed costs (FC), we can more accurately write: $\{[\max] [(pP - vc) - FC] > 0\}$, subject to a system of production capability and marketing constraints.

4) a *capitalistic enterprise,* if the profit organization carries out a *financial* transformation, in the sense that the firm finances its economic processes with external capital in the form of *Equity* [E] and *Debt* [D], forming the *Invested Capital* (IC = D + E);

5) an *economic social actor,* in the sense that it interfaces and interacts with a set of *external,* or *institutional* interlocutors, or stakeholders – in an ethical, social and political (ethical) environment – which influence the organization's structure and processes through a system of *corporate governance*.

The productive organization's autopoiesis is based on the *technical fitness,* that is the capability to:

a) satisfy needs and aspirations and search for new needs and aspirations[4];

b) continually enlarge the variety of products in order to reach new consumers;

c) inprove the quality of production;

d) increase the *productivity* of the processes in order to reduce the unitary factor requirements and the purchased volumes;

e) in particular, increase the productivity of labour through an increase in the quality of the human factor of the organization (skill, motivation, incentives) and its work efficacy (fertility, equipment, software).

The *business* organization's autopoiesis is based on economic fitness, that is on the capability to recursively cover costs, CP = cP QP, with revenues, RP = pP QP, or contain costs within the limits of its revenue, so that in any event: RP ≥ CP for every business and for every investment cycle.

The *profit* organization's autopoiesis depends on the ability to:

1. create a dynamic portfolio of businesses by a virtuous path from question mark to cash cow businesses, through an effective *entrepreneurial function;*

2. achieve the maximum exploitation of the present market and expand toward new markets in order to increase its production volume, QP, and increase as much as possible the selling price, pP, through an efficient *marketing function;*

3. contract the unit factor requirements while expanding the quality of products by means of an efficient *production function*, thereby increasing productivity;

4. reduce the average factor costs through an efficient *supply function* which searches for supply markets where the factors have a higher quality and lower purchase prices.

[4] Needs are *unpleasant* sensations – connected with psychic-physical states of disequilibrium – felt (or imagined) in a given period, and which we wish to eliminate, attenuate or avoid.
Aspirations are *pleasant* states we wish to acquire, maintain or increase.
The distinction between need and aspiration is often difficult to clearly determine, but, at least in theory, one criterion appears to be reliable: the intensity of the need decreases with its satisfaction, except when it reappears at a subsequent period; instead, the intensity of the aspiration increases with its satisfaction (only to then suddenly cease at times when boredom sets in).
For further considerations see Mella, 1991, Ch. 4.

The *capitalistic* enterprise's autopoiesis depends on its ability to finance the long-term invested capital by a portfolio of steadily-available financial capital, matching the length, return and risk of the uses and the sources of financial capital.

We shall introduce the following basic thesis:

a) a condition for the creation and survival of a *capitalistic firm* is that the entrepreneur succeed in developing a portfolio of businesses with sufficient return to acquire and maintain invested the capital necessary to activate and continually renew the productive and economic processes and the investment cycles;

b) the overall fitness of the firm, which guarantees its autopoiesis, is revealed by *financial measures of performance* that denote the efficiency and effectiveness in the production of shareholder value in terms of return and capital gains;

c) the overall fitness includes the *productive* and *economic* fitness, indicated by a system of performance measures that denote the economic and productive efficiency revealed in the production of *economic values*.

The autopoiesis of the firm, when viewed as an *economic social actor*, depends on its capacity to earn the appreciation of the stakeholders who are not components of the organization but who gain external advantages, individual or social, from its existence (Toffler, 1985).

The social unit must produce social shared "value" (Harrison et. al., 1998) in the broader sense that its economic existence as a producer of economic and financial values must be appreciated, in terms of the *sustainability* of the development path of the firm, and evaluated by a wide range of social performance measures of *outcome* or *benefit*: the efficiency of materials; technical innovation; energy efficiency; community relations; eco design; product recyclability; and employee relations[5].

The attainment of perceived levels of social performance produces reputation, brand and confidence, so that the environment itself sets the conditions for the firm's legitimation and consent, which favours autopoiesis and thus a lasting existence for the enterprise as a social unit as well as an organizational type.

This implies, on the one hand, the organizational ability to recognize the set of relevant stakeholders as well as to identify their expectations and, on the other, the capability to communicate the global "value" produced in terms of social benefits and prevented damage to the physical environment.

2. Capitalistic Firms as systems that produce values. Financial performance

There are quite a number of financial performance indicators; however, I feel that only a limited number are sufficient to express the fitness of the capitalistic firm as a system for producing values, according to the basic thesis at the end of the preceding section.

[5] The concept of sustainability was originally introduced in the 1987 Brundtland report, *Our Common Future*, which was commissioned for the United Nations. The central principle of this definition is "development which meets the needs of the present without compromising the ability of future generations to meet their own needs'". (WCED, 1987).

The system of economic and financial values that represent the dynamics of the organization at any particular time can be summed up by the following balance sheet relation:

$$\begin{cases} L + IC = D + E & \text{[financial position]} \\ (CM + CL + CS) + (I + T + R) = RP & \text{[economic position]} \\ (CM + CL + CI) = cP\ QP & \text{[production cost]} \\ OR = RP - (CM + CL + CI) & \text{[economic production]} \\ OR - I - T = R = div + af & \text{[economic distribution]} \end{cases}$$

where L indicates liquidity, IC is the Invested Capital, D and E represent the financial capital in terms of Debts and Equity, (CM + CL + CI) indicates the Cost of factors (Materials, Manpower and Structure costs), I = (D i%) represents the Interests payed on D, T denotes Taxes, R the net income (Mella, 1991), and *div* and *af* indicate the dividends and the self-financing provisions.

The most concise performance indicator is the return on equity, *roe*, defined as the ratio between the net income R and the equity E during a period T: $roe = \frac{R}{E}$.

This indicator is particularly significant in that it expresses, in extremely concise form, the capacity of the firm to satisfactorily remunerate those who have invested equity in it, guaranteeing a return that is sufficient to maintain the capital's integrity, both in monetary terms (preserving its purchasing power), financial terms (financial return, interest, dividend and capital gains at least equal to that obtainable from investments with similar risk conditions), and real terms (capacity to renew investments at the end of their cycle) (Ruefli and al., 1999).

If *roe* is a relevant measure of performance for shareholders, the most important performance indicator for the *financial transformation* is the return on investment, *roi*, which is the ratio between the operating result, OR, and the invested capital, IC, over a period of time T: $roi = \frac{OR}{IC}$.

It is important to observe that *roe* depends directly on *roi* by means of the well-known general law of returns (Modigliani-Miller, 1958):

$roe = [roi + (spread\ der)]$, where $spread = roi - rod$, and $der = \frac{D}{E}$

It is also important to remark that *roi* non only reveals the overall *financial* efficiency of the firm in achieving operating income from a given capital investment, but also represents the most concise measure of *economic* performance. If the firm increases its economic efficiency, either by increasing *OR* and/or reducing the need for invested capital, then the economic fitness improves, as demonstrated by *roi*.

This previous M-M relation clarifies how the firm's general *financial* peformance, indicated by *roe*, is a function both of *economic efficiency*, expressed by *roi*, and the capacity of the firm to acquire a financial structure, expressed by *der*, that permits it to take advantage

of the *financial leverage* effect in the presence of a differential in returns indicated by the *spread*.

From *roe* we can derive other concise indicators of fitness that refer to the firm's ability to meet the expectations of investors: the *economic value added* (EVA), the *dividend on equity (doe)* and the *economic value of the firm* (EVF); we shall consider them in the next section.

3. Concise financial performance measures: EVA, *doe* and EVF.

The initial thesis that the *capitalist* firm bases its autopoiesis on its capacity to regenerate its financial and economic circuits, or loops, implies that the suppliers of both *Debt* and *Equity* financial capital receive a *fair return*, defined as a return at least equal to their *opportunity cost.*

In the most concise form, if we let *roe** stand for the *fair* (adequate, satisfactory) *return* on equity capital expected by the investor which is needed to get him to invest his risk capital in the enterprise – that is, his financial opportunity cost, understood as the return that satisfies his expectations, taking account of the risk and return from alternative investments – then we can derive the minimum net operating results necessary to provide a satisfactory return on the equity capital E: R* = E *roe**.

If at the same time we let *rod** = *i** be the interest rate deemed fair by the investor which is necessary to induce him to invest his finance capital *D*, then we can calculate IP* = *D i**, which represents the minimum net financial return necessary to satisfactorily compensate the finance capital D.

As indicated in the basic assumption, the firm that requires a stable productive investment CI = D + E must then be able to achieve an operating income (OI) sufficient to provide a fair return on *D*, with an interest rate equal to I*, and on *E*, taking into account the income tax T*.

Thus:

$OI \geq I^* + T^* + R^*$.

In the case of an inequality the investment produces a value greater than the sum of the fair financial returns.

This additional amount is the Economic Value Added, which represents a performance indicator that includes *roe* and expresses a concise overall fitness indicator of the agent-firm.

$EVA = OI - I^* - T^* - R^*$

As we have assumed, *economic fitness* is an important component of *financial fitness* and the economic and financial performances are strictly related, as we can prove by redefining EVA with the more meaningful expression:

EVA = IC (*roi- coi),*

in which *cost of invested capital* or *capital cost rate*: *ccr* = *coi* – or also the *weighted average capital cost* (*wacc*) – represents the *cost of investment* and is determined by the

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following expression[6]:

$$coi = \frac{rod\,D + roe^{*}\,E}{IC} = rod\,\frac{D}{IC} + roe^{*}\,\frac{E}{IC} = wacc = ccr.$$

Thus, while *roi* is the *return on investment*, *wacc* represents the part of this return that is needed to pay the interest on the Debt, at an average cost equal to *rod*, as well as to guarantee the shareholders a proper return equal to their opportunity cost, *roe**.

The spread (*roi* – *coi*) thus takes on the meaning of *overall financial performance* (which is independent of the scale of the investment), whose absolute value is instead represented by the EVA, taking into account the amount of IC.

We can also define *coi* = *wacc* as the *roi** - that is, the minimum return for IC that guarantees a *fair* interest and dividend return that would allow the firm to pay back its debts at a cost equal to the *rod*, as well as guarantee a satisfactory return for the *equity holders* in the amount of *roe**.

EVA thus represents a performance indicator of both efficiency and outcome for the *capitalistic enterprise,* since it expresses the efficiency of the firm in achieving a *roi* > *roi** = *coi* = *wacc*.

It then follows that a *second condition* for the existence of the *capitalistic firm*, as defined above, is that it succeed in producing a *roi* such that *roi* > *coi*, which, as we can also see from the equation of *coi*, also implies that *roe* > *roe** (Porter & McGahan,1997; 1999).

Since the *profit organization* is preordained so that {[max] (pP – cP) > 0}, it also follows that EVA = [max].

In general shareholders, being holders of pure investment equity, compare their satisfaction not so much on the basis of the indications from *roe* as on $doe = \frac{R}{E} d = \frac{DIV}{E}$, where *d* is the average dividend rate that would guarantee a self-financing adequate for the firm's growth.

A satisfactory return for the shareholders would require that *doe* > *roe**.

However, since the self-financing obtained from retained profits reduces the periodic returns for the shareholders while also increasing equity, there is progress in the firm's fitness, since it strengthens the financial structure of the firm and reduces the financial leverage with a potential increase in future earnings.

Precisely in order to take account of the inverse relationship between *doe* and *corporate growth* from net self-financing it is useful to determine the *EVF*, which is a concise indicator that reveals the firm's ability to maintain its equity financially integral and produce a value in terms of goodwill that, in the case of listed public companies, can translate into an increase in stock value.

In fact EVF is defined as the level of capital capable of producing a net result equal to that effectively achieved by the firm as a financial transformer, R, under the assumption that this capital was invested with a satisfactory return equal to *roe*°, which is considered acceptable to shareholders.

[6] An equivalent definition is: EVA = [OPBT – Tax – (IC *coc*)] = [NOPAT – (IC *coc*)] where OPBT is the operating profit before tax and NOPAT is the net operating profit after tax (Steward, 1999). A complete tutorial on EVA can be found at: http://www.pitt.edu/~roztocki/evasmall/index.htm

Since by definition EVF * *roe*° = R, and R = *roe* E, with *roe* equal to the effective financial return, through substitution we obtain:

$$EVF = \frac{roe}{roe^{\circ}} E .$$

From the preceding relation we see that if *roe* > *roe*°, then EVF > E, and vice-versa.

If EVF = E, then the agent-firm maintains its risk capital financially integral at the end of the investment. If EVF > E, the agent-firm revalues E and the difference represents *goodwill*. If EVF < E , then E is devalued and badwill is produced (financial loss or negative goodwill).

EVF quantifies the value of the firm, which is considered as an asset for the shareholders, and in its simplest form corresponds to the financial value of the capital that derives from the capitalization of the average standard profit, R, at a rate equal to the opportunity cost to the shareholders (*roe*°).

In general, though not necessarily, we set *roe*° = *roe**, in the sense that the satisfactory return should correspond to that considered appropriate by the investor.

We can easily prove that if EVA > 0, then EVF > E, with the difference representing the value of knowledge (human capital) as well as the value of *goodwill* (Mella, 2002).

It is clear that the firm must manage its own business portfolio so as to provide a fair return to all the capital while also producing an EVA that maintains equity financially integral, thereby producing a goodwill that is proportionate to EVA:

$$EVF = \frac{R^* + EVA}{roe^*} = E + \frac{EVA}{roe^*} = E + \text{Goodwill}$$

From the preceding performance indicators it follows that the fitness of the firm is linked to its capacity to produce:

a) a *roe* which is not below the minimum or fair *roe** necessary to satisfy shareholders, thereby creating value;

b) a *roi* > *roi** = *coi*. If this *second condition* is met, then EVF>E, thereby achieving the financial integrity of the equity capital invested by the shareholders.

4. Productive and economic performance

Even if *roi* and *roe* are the most concise performance indicators, nevertheless the main expression of economic fitness is the capacity of the firm to generate operating income, OR.

Since R = OR – I – T, it is clear that the financial performance involves not only the need to negotiate financing at fair and stable rates – at a level that permits a *financial leverage* – to determine the best place to minimize the tax burden, and to produce a stable flow of self-financing for the growth of the firm, but also, and in particular, the capacity to produce a flow of OI that is sufficient to allow an adequate R.

If we assume we want to establish a fair pP* and a fair cP* - that is, production and sales values compatible with normal supply and sales conditions – then we can determine the fair Operating Income (OI*) produced by the organization: OI* = QP (pP* - cP*), which physiologically is zero in non-profit organizations and positive in profit ones.

The difference: *TEVA* = [OI – OI*] represents the *Total Economic Value Added* by the organization compared to the fair return that the environment could have (fairly) expected from the organization.

If the business organization has a productive efficiency higher than the fair one – so that cP < cP* – then OI > OI* and the difference [OI – OI*] represents the *Total Economic Value Added of Production; TEVAP* = QP [cP* - cP] with product qualities being equal.

If cP = cP* but market efficiency is higher than the fair one, so that pP > pP*, then the *TEVAM* = QP [pP – pP*] represents the *Total Economic Value Added by the Market,* which is obtained from the price side, with sales volumes being equal.

If cP < cP* and pP > pP*, then RO > FR and RO – FR = *TEVAP* + *TEVAM* = *TEVA*.

In the non-profit organization, OI must tend toward zero by definition; thus, the TEVAM must tend toward zero (no increase in prices), with the *TEVAP* obtained from the production side and tending toward zero by a reduction in pP*; the entire *TEVAP* benefits the user of the products and services; thus in the non-profit organization the exogenous teleonomy depends on the capacity to produce values from increases in productive efficiency, since with each reduction in cP with respect to cP* there is a corresponding reduction in pP with respect to pP*. Since it cannot produce value by increasing pP but only by trying to reduce cP, we can see immediately that the operating logic of the non-profit organization must be based on the standardization of production over time and the constancy in its quality and process.

In the profit organization the TEVA is obtained by increasing both productive as well as business efficiency. Its exogenous teleonomy is linked to the capacity to produce the maximum TEVA, whose use for the *capitalist firm* will be examined in detail in the subsequent definition.

Another meaningful indicator of economic efficiency is the *cpc* (cost per cent). If the unit cost of Materials, Labour and Structure inputs is indicated by cM, cL and cS, respectively, the *cpc* can be written:

$$cpc = \frac{QP\,(cM + cL + cS)}{QP\,pP} = \frac{CP}{RP}$$

From *cpc*, it follows that the economic fitness (the economic efficiency) depends mainly on the ability of the entrepreneur and the management to find conditions:

1. to sell increasingly greater volumes of production, by reaching new markets or increasing shares in existing markets and broadening the business portfolio;

2. and/or to negotiate selling prices, pP, which are greater than the average unit costs of production, cP; and/or to produce at average unit costs that are below prices; for example, by looking for new supply markets that reduce the factor costs and modifying the production combinations, or restructuring the product in order to reduce factor requirements, thereby increasing productivity (Arnold & Dennis, 1999; Baumol, Batey Blackman & Wolff, 1989);

3. and/or to search for conditions that increase the rotation of the invested capital, for example by controlling production and stocks, or by searching for greater fertility in the sales outlets, as demonstrated by the well-known relation: *roi* = *cir roc*, where $cir = \frac{CP}{IC}$ is the *Cost Investment Ratio* and $roc = \frac{IR}{CP}$ the *return on cost*.

This shows the relevance of human capital and intangible assets in capitalist production (Griliches, 1996) and the need for:

- *creativity*, by which products and processes are continually innovated (Christensen, 1997; Deephouse, 1999), thereby favoring applied scientific research and technological innovation (Von Hippel, 1995);
- *intelligence* in understanding internal and external processes, in order to rationalize the technical processes of production;
- *organizational learning* and the formation of learning organizations to meet the competitive challenges through new work rules (Schmitz Jr, 2001)
- *management control* (from the Decision Support System to Just-In-Time production) (Wilcox & Al.);
- *a good reputation* for the firm in its environment (Carter & Manaster, 1990).

5. From the corporate balance to the social balance

The system of values achieved by the corporation as a system of economic transformation is reflected in the corporate balance. The very same system of values that lie behind the dynamics of the firm is presented in the budgets.

The corporate balance allows for the calculation of a suitable system of *economic and financial ratios* as well as concise values (EVA and EVF) that translate the values produced into performance indicators in order to assess whether or not the economic-financial objectives of the business and profit organization have been achieved.

These indicators allow those stakeholders (Donaldson & Preston, 1995) who have an interest in the production of value to compare the numerical data with the initial objectives and with the organization's mission (Pellicelli, 2002), highlighting the corporation's efficiency in developing its businesses with respect to its competitors within its particular market and environmental context.

Thus firms should not be considered merely as systems for the production of value but also as economic social actors which operate in a social environment to which they belong and with which they interact, not only through a system of monetary and financial exchanges but also through physical, human and communication flows that produce knowledge, trust and reputation.

Precisely due to the fact that the system of economic and financial values in the balance derive only from monetary exchanges and reflect only the conditions of productive, economic and financial efficiency, the balance that contains such values has three limits with regard to the information it conveys.

In the first place, it is not able to express the conditions for long-term success (Giannessi, 1969) that derive from the non-monetary ties to the social environment.

For example, the balance is not able to explicitly present the social, non-monetary benefits, those resulting from research and development activity, as well as the social benefits with regard to employment in a region, direct and induced, those benefits that involve the production and distribution of income among employees and investors, and the advantages – as well as disadvantages, in terms of pollution and the occupation of public areas – that have an impact on the life of the collectivity.

All of this information is fundamental in evaluating the relationship between the firm and the macrosystem; however, it cannot be included in the corporate balance as understood in an accounting sense: as the representation of the system of values produced by the firm.

Secondly, the traditional corporate balance cannot account for the ethical values and other intangibles which are fundamental to the success of the enterprise in creating economic values (Hinna, 2002).

Thirdly, the statement of produced values does not provide sufficient indications of the ability of the firm to expand in a way compatible with the environmental resources and the social values.

In order to evaluate the overall impact of the firm's activity on the collectivity (Hill & Jones, 1992) it is necessary to come up with a new document that supplements the traditional corporate balance, which is called the social balance (Wilson, 1999), since its objective is to indicate the value created by investments in the social field (Vermiglio, 2000) and, more generally, the results of the firm's social and environmental policy.

Thus, the social balance represents the means by which the firm describes, comments on and reports its role and behaviour with regard to sustainable growth, and through which the firms social actions toward its stakeholders is made visible and transparent (Rusconi, 2000).

6. The social balance as a relational instrument for the creation of value

The social balance thus has the twofold advantage of being an effective instrument for providing information on corporate policy (Gabrovec Mei, 1993) with regard to the optimal use and safeguarding of human, natural and social resources, allowing us to judge the social responsibility of the firm (Keeley, 1988), and for promoting an image of the corporate management that gains the consensus of the collectivity and enhances the reputation of the firm, which in turn is fundamental for ensuring greater trust by the public (Zadek, 2001).

From this perspective the firm, viewed as an economic and social agent, not only produces economic values but represents a value for all the stakeholders. In this manner the social responsibility of every productive organization is revealed.

We can understand the importance of maintaining a high reputation if we interpret reputation as an overall indicator of the organization's quality; as an expression of its social value.

The quality of the products and processes, which is fundamental to the creation of economic values, is not in and of itself synonymous with the quality of the firm when the latter must be judged and appreciated on the basis of its social and environmental impact.

It is for this reason that the social balance is the fundamental instrument to ensure the public's appreciation for the social activities of the firm (Goodpaster & Matthews, 1982), enhancing its reputation in order to create the value of the firm as an actor in the social context as well as to engender trust, which in turn represents the basis for improving the firm's economic and financial transactions and, as a result, making the production of values more efficient.

The social balance thus shifts attention from the creation of *economic and financial values* by the productive organization to the creation of *social and environmental values* by the organization as a social agent.

7. The dialogue with the stakeholders as a precondition for the creation of value

In order to enhance its reputation (Figge & Schaltegger, 2000) and trust, which are the fundamental elements for the production of value by the firm, it is thus important for the firm to be able to demonstrate, by means of the social balance, the extent and limits of its own social responsibility (Simon, 2000).

However, there is a strong risk of self-interested behaviour (Viviani, 1999), since the firm may be motivated to provide information solely – or primarily – on the effects of those policies that present a positive corporate image (Matacena, 2001), with the danger of transforming the social balance into a public relations tool providing only data and information which will favourably impress the public.

The social balance, on the contrary, represents an effective instrument for enhancing reputation, appreciation and corporate value only if it is not considered exclusively for marketing ends, but becomes a means for a social type of planning and control[7].

From this perspective a comprehensive relational process and a continuing dialogue with the other social agents become essential elements for strategy formation (Grant, 2002), which are necessary to create a relationship of trust with the stakeholders (Vaccari, 1998) and a context of shared values. This allows the stakeholders to identify the role, values and the social objectives expected by those who directly or indirectly interact with the firm itself.

This interaction leads to a systematic dialogue with the social agents by means of meetings and other exchanges ("stakeholder dialogue"), in order to grasp in advance the opportunities for an economic development and growth that respects society, without interfering with or changing the objectives (Seabright & Kurke, 1997) of the stakeholders, which often differ from those of the firm (Schmidheiny & Zorraquin, 2000).

The occasions for meaningful exchanges aim to create interactive, shared and transparent communications that result in strong relations with the social actors on the part of both the internal staff as well as the various outside contacts:

- internally, through the virtuous process of shared strategy formation and accountable co-planning, utilizing communication together with training to vertically and transversely "contaminate" the organization and stimulate the feedback flows;

- externally, through the greatest involvement possible of all those with an interest in the firm, whatever their formal relation may be. This should demonstrate that the firm is able to understand and satisfy the expectations of the stakeholders, making these coincide as much as possible with those of the firm. The common objective is to harmonize the various interests in order to improve the quality of life.

A social balance based on a direct relation with the stakeholders guarantees, on the one hand, an awareness of the needs and aspirations (Mella, 1991) of the various parties inside and outside the firm and, on the other, timeliness in understanding and acting on market changes as well as environmental and social ones based on a shared framework.

The sharing and pursuit of objectives by means of the trust that is generated (Chirieleison, 2002) through the development of long-lasting relations leads to the spread of a culture (Kotter & Heskett, 1992) of shared responsibility. This culture is the condition for the

[7] Barbetta G. P., www.terzo-settore.it/Tavolarotonda.htm

organization's success (Parolin, 2002) as well as a source of long-term competitive advantage, which are useful and effective elements for the creation of value in the organization.

8. From social responsibility to the "Triple Bottom Line"

The firm, as a social agent, must base its growth on ethical behaviour (Crivelli, 2001) which involves safeguarding as much as possible the environmental conditions that will be "passed on" to the future generations. Thus the firm must compete on the social and environmental front as well as the economic-financial one.

In fact, in developing its strategies the firm must take into account the concept of *sustainable growth*, which defines the ability of the present generation to achieve a type of growth that, while satisfying the needs of the present, does not compromise the ability of future generations to satisfy to their own needs.

Sustainable growth does not represent an option but a necessary condition to obtain medium- to long-term success. Social accountability thus becomes a factor of strategic importance (Clarkson, 1995).

For the firm, going down the road of sustainable growth means managing its businesses so as to improve its economic results; but at the same time it also means safeguarding the natural environment and promoting social justice (Borzaghi, 2003).

The corporate balance - as clearly shown in the "*Sustainability Reporting Guidelines*"[8] in the "*Global Reporting Initiative*" [9]- cannot by its own nature identify and point out the many ways in which firms influence the environmental and social ecosystems they operate in, beginning with the use of human, natural and capital resources and the creation of value.

The European Commission has asked all the large firms listed in the Triple Bottom Line Reporting (Elkington & Fennell, 1998) to communicate their economic, social and environmental performance[10] to the shareholders, supplementing the economic aspect of their management with the social and environmental ones (Bennet & James, 1999), to the benefit of the relationship with its stakeholders and the markets.

Economic prosperity, *environmental quality* and *social justice* are the pillars on which the creation of corporate value is based, according to the "triple bottom line" (Warren, 1999).

Some conditions are necessary to achieve this form of growth:

1 – a solid governing base supported by an ethical view (Goodpaster, 1991) that is compatible with the shared values regarding the "person" and the "environment"; these values should be explicit and accessible to the stakeholders

2 – the revision of the management processes: planning, monitoring and accounting statements (Elkington & Kreander & Stibbard, 1999), as well as the progressive involvement of the stakeholders in a participatory dialogue which even reconciles contrasting positions, in a continually evolving process of give and take.

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[8] The idea of sustainability has gradually taken hold, to the point where it now refers to a category of firms listed on the New York Stock Exchange. These firms are distinguished by the fact they follow a set of requirements, the Dow Jones Sustainability Index. In Europe the indexes of sustainability are: Ftse 4Good and Ethical index euro (Marcantonio R., 2003).

[9] www.globalreportinginitiative.org

[10] Comunicazione 347, July 2, 2002.

3 - the identification and coordination of the value drives linked to the perception of sustainable growth;

4 - the improvement of the social and environmental performances of the firm, with the consequent enhancement of reputation, which represent essential factors for the legitimization of the firm that increases the trust of the various stakeholders and improves the economic conditions for the production of values (Chiesi & Martinelli & Pellegatta, 2001).

The correct management of the entire process thus leads to the improvement in the firm's reputation, and as a result the creation of sustainable value for the firm (Grant, 2002).

9. The communication of the social and environmental commitment to create value

The creation of social value for the firm is necessary to maintain an effective process for the creation of economic and financial values.

A firm that focusses not only on the quality of the product but also on the safety of its employees, the social impact of its activities and the use of ethically-correct procedures is (Bowen, 1953) creating value (Zadek & Pruzan & Evans, 1997) by gaining the trust of its workers, the market and its collectivity of reference (Tencati, 2002).

The social responsibility of the firm can not be merely a fact of philanthropism or good intentions. We cannot separate the responsibility to earn profits from that of protecting the health of employees, their safety, and from protecting the surrounding social and environmental context.

The social balance represents the instrument for monitoring, financial accounts preparation and communication regarding the responsible management approach to achieve a sustainable growth that respects the shared values of the context in which the firm operates.

The social balance is thus a means for giving value to the firm, since it permits the firm to monitor and prepare the financial accounts for the process of responsible management between the firm and its interlocutors in order to increase its economic advantage and at the same time its social legitimization (Kreeb & Dold, 1994).

10. Measuring social performance and sustainable growth

In order to measure social (Kaplan & Norton, 1992) performance (Clarkson, 1995) we must insert indicators[11] into the social balance (Larsimont, 1979) that allow us to measure the firm's capacity to create well-being for the collectivity (Atkinson & Bunker & Kaplan & Young, 1998) and to demonstrate the firm's social utility by indicating, from both an internal and external point of view, its capacity to achieve social and environmental objectives (Ranganathan, 1999).

The internal performance indicators show the ratio between the outcomes and the means utilized to achieve these outcomes (Haywood & Pickworth, 1988), with the aim of showing the conditions of efficiency (Davis, 1991) needed to produce endogenous teleonomy: that is, the firm's capacity to produce an autopoietic behaviour by continually restoring the network

[11] European Environment Agency (EEA), Environmental signals, Copenhagen, EEA, (2001), http://www.eea.eu.int

of internal operational and cognitive processes that characterize it (Horngren & Foster, 1987). The level of these ratios reveal the social role of the firm, as a "responsible citizen", in using the resources available to it in a suitable way to satisfy the "legitimate" expectations of its various interlocutors.

The external performance indicators aim to examine the conditions for the firm's effective performance in order to reveal the conditions of exogenous teleonomy; here the firm is viewed as an indicator of the capacity to survive in the environment (Costanza, 2000) in which it operates. Effectiveness is shown by the ratios between the actual results and the preestablished objectives (Schalock, 1995). The more the result approaches a unitary value, the greater the firm's effectiveness in pursuing socially useful objectives while demonstrating its "social responsibility" (Drucker, 1995).

These indicators are difficult to identify (Tencati, 2002) because we cannot universally define the variables we need to consider. We must often define specific indicators (Edwards, 1986) to summarize qualitative descriptions (Jones & Sasser, 1994).

In order to ensure homogeneity and standardization (Owen & Swift & Humphrey & Bowerman, 2000) in the presentation of data and to be able to compare the results of the various firms, we should have a system of optimal indicators and draw up a social statement (Perrini, 2003).

The indicators should be determined[12] on the basis of the various groups of stakeholders and adapted to the specific size and organizational features of the firm in question.

An initial group of indicators (Schmid-Schoenbein & Braunschweig & Oetterli, 2001) regard the firm's management, personnel policies and quality (Zeithaml & Parasuraman & Berry, 1990) of work. The main indicators in this group are: the frequency of voluntary resignations, the absentee rate, the movements from one work category to another, the hours of internal professional training, the frequency of worksite incidents and professional illnesses. We can also use indexes of employment segregation based on sex: in other words, for each job level involving similar tasks we can calculate the proportion of female to total personnel. This value for employment segregation by sex can be compared to the average value for other firms in the same sector. Another index of employment segregation regards the nationality of the employees.

A second group of indicators should concern the social well-being of the area in question. To calculate this we can refer to the indicators of economic well-being, the indicators of safety, and the crime rate.

Finally, the indicators (Welford, 1996) regarding the respect for the environment can more easily be standardized and codified in a well-defined and limited manner. Thus the indicators for the firm's respect for the environment are concise and simple, and more often than not are based on certifications approved at the national or supranational levels (Bailey, 1982).

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[12] CSR in Europa", www.welfare.gov.it

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