

Understanding and Measuring Stakeholder Engagement: A Managerial Perspective

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Abstract

If the private sector is to develop the ability to effectively engage with its many stakeholders for positive societal outcomes, it must develop stakeholder engagement as an organisation-wide capability. The stakeholder engagement capability combines attitudes and behaviours. This paper presents an approach to defining and measuring the 'embeddedness' (involvement) of the stakeholder engagement capability and presents evidence that the stakeholder engagement capability has important effects on employees.

Keywords

Stakeholder engagement, corporate social responsibility, measurement, capabilities, employees

Introduction

Stakeholder engagement is an essential capability for companies that wish to be socially responsible. Given that socially responsible companies take care to identify and manage their social impacts (ISO 2004), such corporations need to ensure that managers in all parts of the organisation have the ability to recognise and deal appropriately with the stakeholders who are subject to social impacts.

Stakeholder engagement is also a criterion by which the social performance of corporations is judged. For example, the AA1000 standard requires firms to integrate stakeholder engagement into their daily operations (Zadek 1999). Social investment indices, such as the Dow Jones Sustainability Index, give more weight to stakeholder engagement than any other social impact measure (DJSI 2003) and the GRI social reporting guidelines recommend companies report on their policies and procedures for engaging with community stakeholders (GRI 2002). Implicit in these standards, guidelines and performance measures is the notion that corporations must develop the ability to engage with stakeholders. Such ability is not specified or measured by these initiatives; rather, the presence or otherwise of stakeholder engagement policies and procedures are taken as a proxy for effective stakeholder engagement. These are blunt measures of stakeholder engagement that do not yield managerially useful information that can guide strategy development or predict future performance. To address the difficulty of measuring stakeholder engagement, the study

reported in this paper aimed to define the stakeholder engagement capability and develop a method for measuring the extent to which the stakeholder engagement capability is present or otherwise within corporations.

Stakeholders are those groups or individuals who can affect, or are affected by, the firm's activities because of their material, political, affiliative, informational, symbolic or spiritual interest in a firm (Wartick and Wood 1998). Corporations have many stakeholders, including employees, customers, investors and communities. Employees are arguably the chief among these stakeholders as it is this group upon which a corporation is reliant to deliver its products and services. Further, stakeholder engagement is thought to affect employees by increasing their morale and loyalty but with a few notable exceptions (e.g. Zappala 2003; Cruz Deniz-Deniz and Saa-Perez 2003), there is little empirical evidence. Therefore, this study selected employees as the stakeholder group of focus in order to test the construct and measures of stakeholder engagement.

This paper first defines stakeholder engagement capabilities and sets out the method for measuring them. It then presents empirical evidence of stakeholder engagement capabilities in a study of manager level employees at Westpac Banking Corporation. The quantitative results are triangulated with qualitative evidence from interviews with senior executives.

Theoretical framework

The theoretical framework for this paper draws on two bodies of literature. First, the stakeholder literature is used to understand the constituent elements of stakeholder engagement. Second, an emerging strand of the strategic management literature concerned with organisation-level capabilities is used to understand how stakeholder engagement might be embedded within a corporation.

Stakeholder engagement

Early definitions of corporate social responsibility emphasised the need for managers to know and understand the firm's stakeholders and recognise the interdependence of firm and stakeholder interests (cf. Preston and Post 1975; Ackerman 1977). However, later work gave more emphasis to the processes and structures required for identifying and understanding stakeholders and weighing decisions about strategic responses according to the stakeholder's salience (Mitchell et al. 1997; Berman et al. 1999). These processes were called stakeholder management.

In contrast, stakeholder engagement is a broader concept that encompasses relationships that requires an organisational capacity for engagement (Lawrence 2002) . As a component of stakeholder engagement, stakeholder management requires managerial commitment and learning (Post et al. 2002), and establishing organisational structures and policies (Donaldson

and Preston 1995; Jones 1999). A five-step framework for stakeholder management, presented by Carroll and Buchholtz (2000, pp. 73-85) says managers should identify who the stakeholders are, understand what their stakes are, identify the opportunities and challenges presented by the stakeholders to the firm, consider the firm's responsibilities to its stakeholders, and then, select strategies for dealing with stakeholders such as collaboration, defence, negotiation and so on. Thus, stakeholder management refers to a configuration of activities, managerial orientations (cognitions and values), and ethics (Johnson-Cramer et al. 2003) and is bounded by conditions such as stakeholder autonomy and alignment of firm-stakeholder interests (Heugens and Oosterhout 2002).

From these definitions it is clear that stakeholder engagement contains two discrete components. The first describes the ability of managers know and understand the firm's stakeholders and recognise the interdependence of firm and stakeholder interests (cf. Preston and Post 1975; Ackerman 1977). This is the cognitive aspect of stakeholder engagement. The second component provides a behavioural basis for stakeholder engagement that goes beyond the need to select strategies for dealing with stakeholders (cf. Carroll and Buchholtz 2000) and suggests that firms must build cooperative, mutually reinforcing relationships (cf. Heugens et al. 2002). This requires managers to take stakeholder needs and interests into consideration in day-to-day decision-making.

Therefore, I conceptualise stakeholder engagement as having two components. The first is the extent to which the firm sees its long term interests linked to those of its stakeholders, labelled 'stakeholder identity'. The second is 'stakeholder management', which means bringing stakeholder interests to bear on operational decision-making.

Capabilities

Firms that effectively manage these often complex stakeholder relationships require a well developed stakeholder engagement capability. Capabilities are unique bundles of knowledge, skills and processes which arise from tacit knowledge, span levels of the organisation, and enable the activities in a process to be carried out (Teece et al. 1997; Sharma and Vredenberg 1998). The capability for stakeholder engagement draws on the knowledge, understanding and behaviour of people in all parts of a company, working through structures and processes that cross traditional organisational boundaries such as hierarchical levels or business units. The stakeholder model of the firm (Post et al. 2002) suggests that social responsiveness capabilities may be conceptualised at a generic level, even if the implementation is unique because of a firm's given configuration of markets, resources and stakeholders.

Hypotheses

The stakeholders of a firm can include employees, customers, communities, investors and suppliers, among others. Stakeholder engagement is thought to positively affect employees by increasing loyalty and commitment, but with few notable exceptions (e.g. Cruz Deniz-Deniz and Saa-Perez 2003; Zappala 2003), little empirical evidence is available. This is despite the existence within the human resources discipline of robust measures of these constructs. This study therefore focused on the employee stakeholder group. Stakeholder engagement is thought to have several consequences for employees.

First, a firm that effectively engages with stakeholders will include employees among those stakeholders. As an expression of its commitment to positive employer–employee relationships, a firm may be likely to invest in its employees by providing them with training, counseling, employment security and opportunities for advancement (Tsui et al. 1997).

Second, stakeholder engagement requires firms to use value-based decision processes and to cooperate with stakeholders. Value congruence and cooperative behaviour are central to the concept of organisational identification. Organisational action on social issues is more likely when the issues are salient to work-related identities (Pratt and Dutton 2000). Thus, decisions by managers to cooperate with either external or internal stakeholders may be influenced by the extent to which they identify with their organisations (Dutton et al. 1994). Organisational identification occurs when an individual's self-perception is actively connected to the organisation's identity (Elsbach 1999), creating a sense of oneness with the organisation (Mael and Ashforth 1992) to the extent that an individual's beliefs about his or her organisation become self-defining (Pratt 1998). Identification is manifested when employees make decisions that are in the firm's interests; that is, their decision-making processes are guided by the organisation's values and goals (Schrodt 2002).

Closely related to the construct of identification is the construct of commitment. But whereas identification refers to a self-image which invokes an organisation's image (Miller et al. 2000), commitment is a psychological state of attachment (Meyer and Allen 1997). Commitment correlates negatively with employees intention (e.g. Mowday et al. 1979; Schwepker 2001). Thus stakeholder engagement should be positively correlated with employee commitment and negatively correlated with intention to leave. Therefore, this study developed these hypotheses:

- H1: Stakeholder engagement will be positively related to employer investment in employees.
- H2: Stakeholder engagement will be positively related to organisational identification.
- H3: Stakeholder engagement will be positively related to organisational commitment.
- H4: Stakeholder engagement will be negatively related to employees' intention to leave their organisation.

Method

Measures of stakeholder engagement used in standards, guidelines and performance assessments such as AA1000, the GRI or the DJSI rely on the existence or otherwise of processes and policies for stakeholder engagement. They are thus too blunt to be of use to managers who wish to understand the strength or extent of stakeholder engagement capabilities within a corporation or within a section of a corporation such as a business unit or geographic location.

Given that capabilities are the product of attitudes, beliefs and understandings on the one hand, and of complex decision-making behaviours on the other, perception-based measures offer a solution to this measurement challenge. Perception-based measures offer a number of attractions for measuring stakeholder engagement capabilities. First, they enable us to quarantine the differences between organisations because of their industry or products and services and provide a basis for comparison on universal criteria. Second, perception-based measures are supported by a large body of scientific knowledge that enables us to test measures for their reliability, validity and measurement error. Third, perception-based measures have been shown to be a reliable proxy for objective measures (Dess and Robinson 1984).

I therefore chose to develop psychometric scales to measure the 'embeddedness' (involvement) of stakeholder engagement capabilities. Psychometric scales are popular in psychology, marketing and management because, when well developed, they are short and accurate (Hinkin 1995). Psychometric surveys measure intangible concepts by asking respondents to indicate their level of agreement with several statements which each reflect a part of the intended meaning of the concept being measured (Nunnally and Bernstein 1994).

Development of sound psychometric measurement tools relies on two statistical techniques, factor analysis and calculation of reliability coefficients. Factor analysis groups together statements with meanings that are highly correlated. I used factor analysis to identify whether there was evidence for two dimensions of the stakeholder engagement capability, i.e. cognitive and behavioural. Reliability coefficients show the extent to which statements comprising a factor converge on a common meaning. A clear factor structure (i.e. statements belong to one factor only) and reliability coefficients of .70 or more are desirable (Nunnally and Bernstein 1994).

The scales to measure stakeholder engagement were developed in a series of studies reported elsewhere (Black and Hartel 2002; Black 2001; Black 2002; Black and Hartel 2001; Black and Hartel 2003). These were: 1) a qualitative exploration of the concept of stakeholder engagement through interviews with 18 public affairs and non-public affairs

managers in 13 companies from which the initial measurement tool was developed; 2) a large-scale quantitative survey of Australian public affairs managers to test the scales; 3) focus group discussions with public affairs managers to further refine the scales; and 4) a further survey test of the construct of stakeholder engagement capability and a case study. This paper reports results from the fourth part in the series, undertaken in 2003.

To test the validity of the stakeholder engagement capability construct, the scales were incorporated into a theoretical model and used in an employee survey which measured some of the hypothesised consequences of stakeholder engagement (n = 248, RR = 38%). The construct of stakeholder engagement capability was triangulated through a series of in-depth semi-structured interviews with eight executives from the senior management team. The study site was Westpac, a large Australian bank that has won a number of awards for social responsibility and was therefore thought to have well developed stakeholder engagement capabilities.

Results

Psychometric properties of the stakeholder engagement scales

A seven-item scale to measure stakeholder engagement split into two hypothesised factors when subject to factor analysis with Varimax rotation. The first factor which described the stakeholder identity component of stakeholder engagement comprised four items with an alpha coefficient of .80. The second factor which described the stakeholder management component of stakeholder engagement comprised three items with an alpha coefficient of .63. Thus, the scales demonstrated adequate to good reliability. The factors were subsequently converted into variables for which scores could be calculated, and used in hypotheses testing. Scores were calculated for stakeholder engagement across Westpac's business divisions and across management levels and are depicted respectively in Figure 1 and Figure 2.

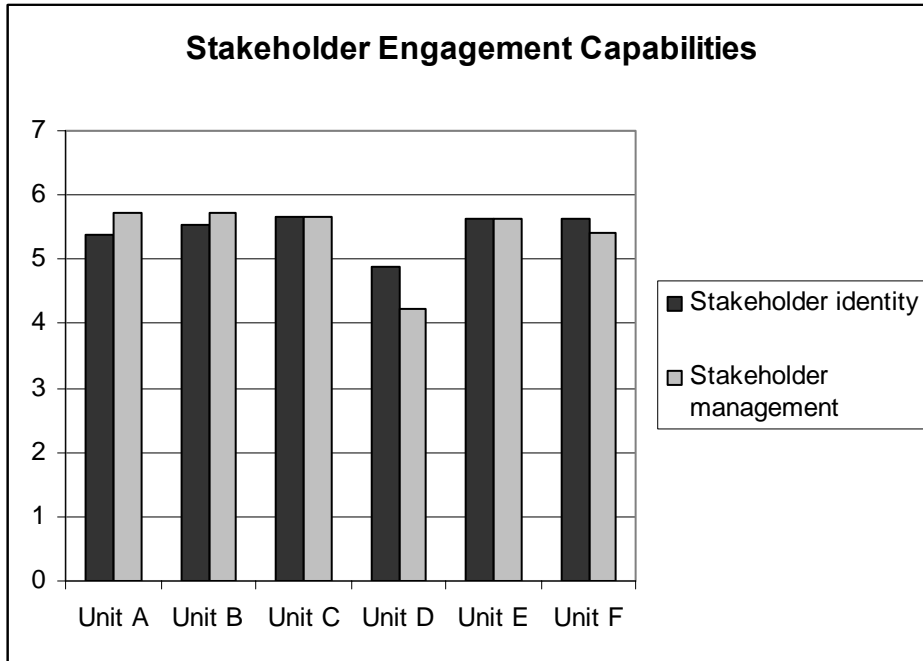


Figure 1. Stakeholder engagement capabilities across business units

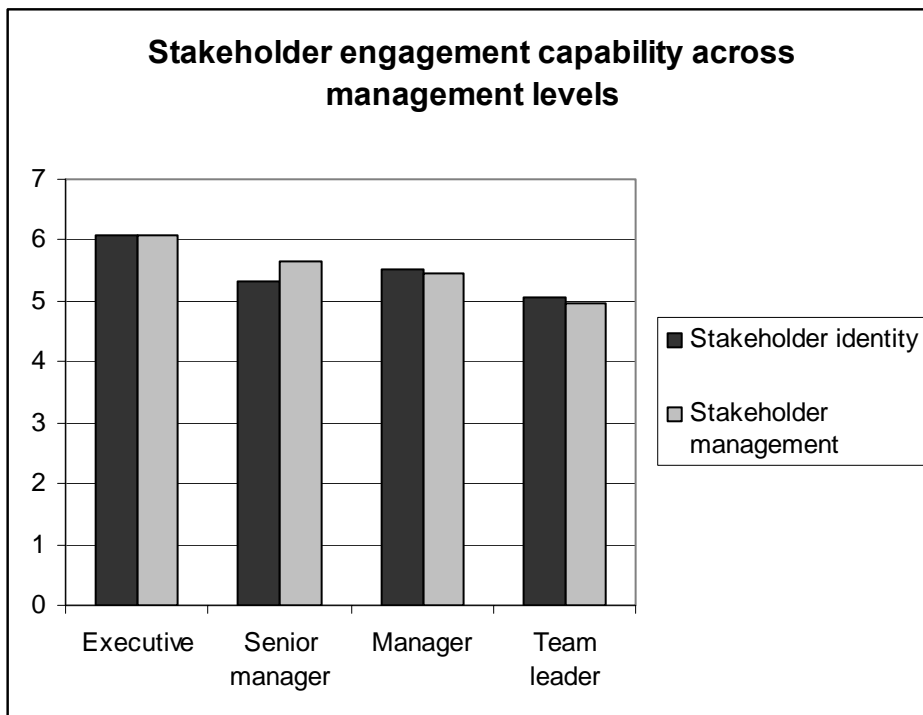


Figure 2. Stakeholder engagement capabilities across management levels

Results of hypotheses tests

Each of the four hypotheses was confirmed. That is, both components of stakeholder engagement independently contributed to perceptions of increased employer investment in employees, organisational identification, organisational commitment and reduced turnover intention. However, the stakeholder identity component accounted for significantly more

variance in these outcomes than the stakeholder management component. Tests for differences between the business divisions indicated significant differences only in stakeholder identity ($F(5,237) = 4.666, p < .001$). This suggests that effective stakeholder engagement relies much more on the extent to which employees understand the ways in which their firm's prosperity and stakeholders' prosperity is connected than on the management processes that are used. These relationships are depicted in Table 1.

Table 1. Regression results for stakeholder engagement capability

Dependent variable	Independent variable	F	E2	β
	Stakeholder identity			
Organisational identification		34.137	.131***	.287***
Organisational commitment		59.89	.209***	.321***
Employer investment in employees		35.766	.137***	.544***
Turnover intention		13.092	.193***	-.242***
	Stakeholder management			
Organisational identification		6.245	.027*	.122*
Organisational commitment		8.284	.035*	.123*
Employer investment in employees		13.934	.058***	.332***
Turnover intention		2.041	0.009	-0.091

* $p < .05$

** $p < .01$

*** $p < .001$

Evidence from interviews

Interviews with eight senior executives at Westpac sought to understand whether stakeholder engagement could be conceptualised as a capability with two discrete components as described above, i.e. stakeholder identity and stakeholder management. The interviews also provided rich description of the capabilities in action.

A firm needs to identify with its stakeholders to recognise the validity of incorporating their needs into business decisions. An executive explained it like this: "You would put yourself in their shoes, you wouldn't see yourself as somehow being above or different to or better than them" (WBC8).

The tight link between stakeholder identity and stakeholder management is illustrated in the following anecdote which contrasts the 'then and now' approach to the thorny issue of branch closures. In this anecdote, the ability of bank executives to identify with the needs of

stakeholders who would be affected by a branch closure is clear, and the ways in which this identification influences business behaviour are elaborated.

“An organisation, as we once were, without much focus on [social responsibility], would close branches by pinning a notice on the door at four o'clock on a Friday, which would be the moment at which you would tell the staff ... The person who pinned that notice would deliver redundancy notices, basically high-tailing out of town, knowing that there would be a battle and then someone in media (public relations) would be tasked to try and put a positive spin on it. An organisation that is focused and serious about social responsibility may ... [close a branch], but would do it in a completely different way. They would go to the town and talk to people about why we were thinking about closing a facility ... [and] whether there were other options available ... We would think about the job implications, and whether it is possible to move people or if we were going to change the way we're doing business, whether we could help people find other employment or do other things, and we would talk to all the local stakeholders about those issues, try and come up with a solution that works for everybody” (WBC 8).

In the case of branch closures, Westpac developed the 'in-store' solution, whereby basic banking facilities are retained in an area after a branch closure by moving those services into the premises of another local business such as a newsagency or post office.¹ Thus, stakeholder identity (recognising the interconnection between the firm's interests and stakeholders' interests) led to stakeholder management (factoring stakeholder needs into business decisions).

Stakeholder management requires several well-developed skills, according to executives in this study. First, environmental scanning and issues management, especially “bringing the right perspective” to issues, is essential. Public affairs employees play a critical role in helping business managers integrate stakeholder needs into their decision making. A public affairs executive described how public affairs employees use environmental scanning processes and the access to both senior management and operations managers required to make sure that stakeholder needs get attention:

“We normally pick up the early warning symptoms a long time before others and because we have a direct route to the top, pretty much unfettered access in the company. Even if the signals are picked up elsewhere, the various pressures and the forms in which performance may be judged in the business ... impact the pace at which businesses accept that, for example, an emerging issue, is a broad based concern and particularly a growing public concern. ... our role is to actually get them

¹ Westpac halted branch closures in 2001.

on to the radar scope, get them on to the agenda of the company and make sure that they actually get managed” (WBC4).

Part of the integrative role means acting as a ‘bridge’ between stakeholders and the firm so that ‘the right perspective’ can be brought to issues:

“There is often a disconnect between where the hearts and minds and emotions of the stakeholders or the community or the media interests are and where the organisation thinks that they are. A big part of our job is to be able to bridge that and have people who are skilled enough to do that. And in that sense, it’s bringing balance to it so that in fact there is the right perspective around the issues. Are the issues, for example, issues which can be simply communicated away with some information, or are they issues of fundamental substance? And we play a part in actually getting traction around those issues” (WBC4).

This quote shows how public affairs plays an integrative role both between the organisation and its stakeholders and within the organisation by bringing stakeholder perspectives to the attention of operations managers. Thus, the public affairs function helps other managers increase their stakeholder identity.

Public affairs can also facilitate effective stakeholder management by identifying how stakeholders need to be empowered to be in a relationship with a focal corporation, and by facilitating relationship development. For example, stakeholder education, especially financial literacy, is often required so that stakeholders have the capability to be in a relationship with the Bank. Financial issues can be extremely complex, requiring bank executives to spend time educating stakeholders or increasing their financial and economic literacy.

“We find, and it’s certainly my philosophy, [that] the more educated these stakeholder groups are, the more you can develop a cooperative relationship ... for example our chief investment officer recently held a briefing for all NGOs in the green movement ... which was our way of trying to contribute to the store of knowledge“ (WBC6).

Executives advocated a relationship-based approach to stakeholder management because “you do business by building relationships first” (WBC6). Attempts at managing issues or resolving conflict can founder if they are not built on a pre-existing relationship, as explained by this executive:

“If you don’t have the relationship as a platform, and the first time you meet is when the stink is on, everyone’s mind is already made up. ... From the institution’s perspective, here’s another bunch of ill-informed tree huggers making our life

miserable, and from the other side, from the non-government organisation's view, here is a bunch of privileged dickheads in suits and what the hell would they know about the future of the planet, both of which [perspectives] are manifestly wrong, as time has demonstrated quite clearly" (WBC6).

Trust, honesty and openness are essential relationship maintenance strategies for this executive because their lack can backfire.

"From my own perspective, some of the bullshit that goes on in terms of trying to tell white lies and representing things in a different way, I don't think it works, because it comes back to bite you. These organisations (stakeholders), they've got smart pieces (people) in a lot of instances and at the least extremely passionate people who pick up ... on body language, they pick up on what they sense and if they sense that you're being evasive or possibly not behaving properly, they will respond to that. So, [you've got to] put it all on the table, and you've ... just got to trust" (WBC6).

In summary, both components of the stakeholder engagement capability are evident in the accounts of Westpac executives.

Discussion

This study has produced a reliable and valid conceptual framework and measurement tool that can be used for change management purposes to help organisations become improve their stakeholder engagement capability. Improvements can be sought by understanding the relative strengths and weaknesses across an organisation in stakeholder engagement capabilities and identifying strategies to leverage strengths and redress weaknesses.

In this study, the ability of employees to understand the interdependencies between stakeholders and their firm was more important than the management processes used to deliver stakeholder engagement. This suggests that communications and symbols as evidenced in an organisation's culture are the primary routes to improving stakeholder engagement capabilities. Talking about the relationship of the business with its stakeholders and the role of the business in creating positive impacts for stakeholders is central to the stakeholder engagement capability, and by extension, is underpins a company's ability to be socially responsible.

The study also points to the significant impact of stakeholder engagement on employee stakeholders. The literature on organisational identity and identification provides a means for interpreting the significance of these findings. Research suggests that individual identity is formed in part by how people define themselves in terms of the groups that they belong to (Tajfel and Turner 1986). The sense of self that is derived from organisational membership is

extremely powerful; individual needs for self-esteem, self-knowledge, social interaction, emotional wellbeing and uncertainty reduction can be served by identification with an organisation (Hogg and Terry 2001, Pratt 2001). When employees feel that they belong to a high-status organisation they feel pride in their organisation and loyalty towards it. Pride, in turn encourages cooperative and predictable behaviour, such as reduced intention to leave the organisation.

Further, organisational identity can provide a context for organisational strategy which may contribute to competitive advantage. Organisational identity influences how members perceive issues and what they will do about them; that is, it can influence whether and how the organisation acts on its social responsibilities. A firm that acts on its social responsibilities maintains ongoing dialogue with its stakeholders, which provides opportunities for firm members to see an image of their firm reflected back to them by stakeholders. Through this process, the organisational identity enters a dynamic whereby the ongoing dialogue between the firm and its stakeholders helps define the firm. When a firm's identity is co-created by 'insiders' and 'outsiders', the likelihood increases that stakeholder issues will be recognised and acted on.

The results of this study suggest that the effect of stakeholder engagement on employees' identification with and attachment to their firm is one of the key dynamics that produces business benefits by affecting human resources outcomes.

Limitations of the study and future research direction

The limitations of single-site studies apply to the research reported here. Replication in other firms and in different industries will help understand the extent to which the stakeholder engagement capability measure is universally applicable. Further, the effectiveness of stakeholder engagement may be predicted by stakeholder engagement capabilities, but it can only be measured by capturing the perceptions of the stakeholders themselves. Adaptation of this instrument for use by stakeholders is clearly an important goal for future research.

Conclusion

This study has argued, and shown, that stakeholder engagement is an organisation-level capability that can be defined and measured and used to develop capability improvement plans. When integrated into operating practice, stakeholder engagement has the potential to reduce costs through reduced employee turnover and deliver competitive advantage by motivating employees to make decisions that are guided by the organisations values and goals.

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