

Legitimacy Theory and a Compliance Analysis of Tesco's 2008 Business Review

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The issue of whether business has obligations to society, and what those obligations might be, has been disputed in academia for a number of decades now. The debate between Friedman's shareholder primacy model, and the much more inclusive idea of stakeholders, has taken centre stage with the passage of the UK Companies Act 2006. In the section dealing with directors' duties, we argue that profit maximisation is now the legal purpose of the company. However there is now a level of institutional legitimacy provided by the Act which allows directors to consider and take into account the role of stakeholders in the company. We consider a model of institutional legitimacy that involves the Government, the company and stakeholders, when looking at the duty to consider stakeholders, and the requirement to report on how that duty has been complied with. We have selected Tesco PLC as it a well known UK company which voluntarily presents itself to the public that it is a socially responsible company and reports on its social, environmental and sustainability aims and achievements. The Business Review provided by Tesco PLC in its 2008 Annual Report is considered in light of our model, to determine whether it complies with the provisions of the reporting section. We conclude that the Review, whilst no doubt intending to show compliance with the Act, does not in fact do so. The bulk of the Review is inwardly rather than outward focused, losing a valuable opportunity to legitimise the place of the company in society.

Keywords: Corporate Social Responsibility; Tesco Plc; UK Companies Act 2006; Stakeholders

1. Introduction

Over the last few decades there has been increasing debate over the relationship between companies and society and increasing attention given to a company's obligations to stakeholders, other than shareholders. What those obligations might be has largely been the focus of dispute within this debate. In 1970, Milton Friedman stated:

[F] have said that in such a society "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it remains within the rules of the game" (p.32).

Since that time, however, there has been increasing disagreement with the idea that the purpose of a corporation is solely to maximise outcomes for shareholders (the shareholder primacy approach to business). There has been much debate over other approaches to ethical and managerial responsibilities. These discussions are generally summarised under the heading of Corporate Social Responsibility (CSR), a concept that directly contradicts Friedman's dictum and that Carroll (1999) defines as, "encompass[ing] the economic, legal, ethical, and discretionary expectations that

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society has of organizations at a given point in time” (p283). Such a definition is premised, amongst other things, upon the understanding that a social responsibility exists between business and those stakeholders whom have a relationship with or are dependent on that company (p.282).

These societal expectations were apparently influential in the recent regulatory reform of company law in the United Kingdom. After a number of years of consultation and discussion, the UK Companies Act 2006 (CA 06) was passed in October of that year. Within the part of the Act dealing with directors’ duties is Section 172, which requires directors to act in good faith to promote the success of the company.

Section 172 goes further, however, and sets out in statute the purpose of the company – namely to provide benefits for members (shareholders). To all intents and purposes, as we discuss later in this paper, the Act has now provided a legal *imprimatur* to Friedman’s shareholder primacy paradigm. At the same time, to moderate the effect of a regulatory embodiment of a company’s “raison d’etre”, directors are now required to consider a non–exhaustive list of factors (stakeholders) in carrying out the business of the company. The list is deliberately left incomplete, to allow directors to make the final determination as to whom the company’s stakeholders might be, but it is in reality a “discretionary” discretion. By this we mean that directors must consider whether any, all, or none of the factors are relevant to the operations of the company at any given time, and if one or more of the factors is relevant, then to what extent consideration must be given to that interest.

The Company Law Reform Steering Group referred to this change as “Enlightened Shareholder Value” (ESV). The Minister responsible for the CA 06, Margaret Hodge, justified the change as

...a radical, historic and vital cultural change in the way in which companies conduct their business....We believe that businesses perform better, and are more sustainable in the long term, when they have regard to a wider group of issues in pursuing success (Hansard, 2006b).

To balance the discretion given to directors in carrying out this duty, the Act also included reporting requirements. Section 417 states that shareholders are to receive from the directors a Business Review (BR), contained in the annual report, which shows, amongst other matters, how the directors have complied with Section 172.

The act of specifying stakeholders of whom directors should take notice when they are making decisions for the company has arguably created a statutorily sanctioned change from Friedman’s “rules of the game”. If the Minister is correct in her celebration of the radical change towards CSR, there is now a statutory context by which it is impressed on directors that a relational approach, or in Kantian terms, an approach that treats stakeholders as intrinsically valuable, rather than as a means to an end, or irrelevant to the company’s purpose, will produce success, and corresponding benefits for members. Such benefits include better performance and long term sustainability of the company, as well as possible “bottom line” benefits (DTI, 2007a).

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In order to analyse the impact of this change in legal direction, we will first provide a brief history of the legislative changes. Then we will look at institutional legitimacy justifications for imposing obligations of this nature on directors. In doing so, we will consider whether these provisions are likely to change the manner in which companies are governed.

The next section of the paper will utilise, for the purpose of assessing the effect of this change, a functional analysis of Tesco PLC's 2008 BR, to consider its compliance with the new legislative requirements. Tesco PLC was selected as it is a large UK company which proclaims that it engages in practices which consider its social impacts on the wider community. In recent years in the UK there has been increasing attention given to CSR issues. Institutional investors in the UK encourage more disclosure of social and environmental matters and then factor "social and environmental behaviour into their investment decisions". (Aguilera, Williams, Conley and Rupp, 2006, p. 156). Thus we expect that compliance with the statutory reporting requirements would not be difficult for Tesco, given the scope of its voluntary reporting. Finally we will discuss our findings from this analysis, and conclude.

2. The Companies Act 2006

The UK Companies Act 1985 contained provisions requiring directors to consider employees, both with respect to taking into account their interests (Section 309), and reporting on the company's management of its employees in the required Directors' Report, which was to include a review of the company's business (Section 234). The only other stakeholders specifically identified in the 1985 Act as requiring separate consideration by directors were members. General directors' duties were not set out in statute, but were governed by common law.

In 1998, the Department of Trade and Industry (as it then was) commenced a review of company law, with a view to modernising this area of law by rewriting the Companies Act 1985. Included in this review were questions about corporate governance, and directors' duties. A Steering Group undertook a Company Law Review (CLR), and created a series of reports containing, amongst other things, recommendations for change and questions for consultation (Johnston, 2006). As Johnston notes,

The main recommendation as regards corporate governance was that the law should be updated to reflect the shift from managerialism to shareholder value, but with the proviso that this legally mandated shareholder value would be 'enlightened' by two main mechanisms: an 'inclusive' statement of directors' duties, which would direct those controlling companies to take account of a range of stakeholder interests as a means to achieving the primary goal of producing shareholder value, and an Operating and Financial Review (OFR), which would compel listed companies to disclose a range of 'qualitative' and 'forward-looking' information of a kind that is not normally found in traditional financial statements (2006, p.818).

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This OFR was formalised in The Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005 (SI 1011). These regulations encompassed the non-financial reporting requirements of the EU 2003 Modernisation Directive (European Commission, 2003), which the UK as a member of the EU was required to have implemented by 1 January 2005 (OPSI, 2005a), as well as implementing the OFR. One very important aspect of the OFR, in our opinion, was a requirement that the non-financial information in the Review be subject to oversight by an external auditor. The auditor was to consider the OFR in the context of the financial statements, and provide an opinion as to whether the non-financial information was consistent with the financial accounts, and vice versa for financial information and the OFR (Regulation 10, OFR Regulations). The audit requirement, we believe, showed the seriousness with which the DTI viewed the necessity of transparent reporting.

However, only a matter of months after the Regulations came into effect on 1 April 2005, the Chancellor of the Exchequer announced that they would be repealed, in favour of a less prescriptive (and more cost-efficient) reporting obligation (Johnston, 2006). The new report would be called a Business Review, and would form part of the Annual Report. The new obligations were contained in the Companies Law Reform Bill introduced into Parliament in November 2005 (Johnston, 2006). The Explanatory Notes to the repeal Regulation (OPSI, 2005b) state:

The Business Review includes the key material reporting requirements and performance indicators that are necessary to monitor business performance and risks, including on environmental and employee issues (where these are material to the business). Therefore, it has been concluded, on reflection, that the OFR requirements are unnecessary (Para 7.2).

Section 417 of the CA 06 therefore replaces the OFR. Thus compliance with the reformulated directors' duty found in Section 172 must be reported in the Business Review (BR) section of the Directors' Report. As Section 417(2) states, "The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company)". Relatively detailed instructions are provided in subsequent subsections to guide directors as to how to comply with this requirement. This includes, as Horrigan (2007, p.112) states, "both backward-looking and forward-looking elements", but the reporting must be specific to the company, "to the extent necessary for an understanding of the development, performance or position of the company's business" (Section 417(5)). Therefore, the content of the BR is now completely within the control of the directors. Shareholders must trust the directors to report appropriately.

This new form of reporting may well provide information and possibly even benefits, to stakeholders of the company, but the reporting is completed only for the benefit of members of the company. Nonetheless, the fact that directors are required to report on their compliance with the duty in section 172 presupposes that they have so complied, thus by inference, it is acknowledged that stakeholders do have to be taken into consideration in determining the direction of the company. Dignam says, in relation to this regulatory reformation:

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In many ways, the report of the CLRSG, the OFR/FBR and the Companies Act 2006 proposed codification of directors' duties are important because, although they may do little to disturb the status quo, they do succeed in legitimising stakeholder issues in the business community (2007, p.34).

It is the issue of legitimising stakeholder issues that we wish to consider in the next section of the paper.

3. Legitimacy Justifications for Sections 172 and 417

Much was said in the reports from the CLR and the Department of Trade and Industry, as well as the Parliamentary debates during the passage of the Company Law Reform Bill about this “new” approach to directors’ duties, which, as Keay (2009) states, “has no obvious precursor” (p.103). So why would the UK Government wish to impose such a duty on its company directors, a duty which “probably led to more debate in the Parliament than any other provision contained in the whole CA 2006” (Keay, 2009, p.103)?

As noted above, the concept of ESV first appeared in the initial report generated by the Company Law Review (1999). Harper Ho explains the link between CSR and ESV, when she says that ESV “emphasizes the benefits to shareholders that result from focusing corporate management on areas of shared shareholder and stakeholder concern, while recognizing the very real challenges posed by the diversity of shareholder and stakeholder interests” (2010, p.3). The Steering Group (SG), as Keay (2009) notes, had considered both the status quo – which it interpreted as a paradigm whereby for-profit companies were managed primarily for the benefit of their shareholders – and other, more inclusive, options for managing a company.

A review of this nature was part of the CLR terms of reference. The SG was required to consider the place of company law in relation to “wider areas” such as the economy, the European Union, changing asset structures, and globalisation (Company Law Review, 1999, p.v). Among the options considered were a “pluralist approach” to managing a company, in other words, a stakeholder primacy framework, and ESV, which “can be achieved within present principles, but ensuring that directors pursue shareholders’ interests in an enlightened and inclusive way” (Company Law Review, 1999, p. v).

Nonetheless, although the focus of the Review was on the law, it was not, and could not, be strictly legalistic in its conceptualisation. The SG states in its first report:

*The Review is essentially concerned with **law** reform, not with wider ethical or managerial issues about the behaviour and standards of participants in companies, except to the extent that it is appropriate to reflect them in company law. So we focus on the components of such reform - i.e. directors' and shareholders' powers and duties, their extent and limitations, and related rights, remedies and liabilities. Proposals for **legal** reform can be expressed only in such terms. However, behaviour in this field is influenced by a wide range of other factors, which motivate*

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and guide those involved. Design of the law needs to recognise the importance of these. It also needs to recognise that some important key concepts vary in meaning over time as well as in different contexts (emphasis in original) (Company Law Review, 1999, p. 33).

We therefore, consider it appropriate to look at a theoretical justification consistent with this “radical” change to company law, of which Hodge states that, “The best way of achieving lasting cultural change is to go with the tide and the broad consensus of opinion” (DTI, 2007, p.3). This theoretical understanding will in turn inform the compliance section of this paper, in that we will consider Tesco’s 2008 BR in light of the intended spirit of the legislation, rather than from a strict “letter of the law” mindset.

3.1 Institutional Legitimacy Justifications for the ESV Duty

The SG’s initial report spent some time considering the issue of company relationships, both internal and external to the company. It was stated that “Not all such relationships need to be co-operative and long-term; but very often relationships of this kind are important ingredients of success” (Company Law Review, 1999, p. 36). If a company is to have the ability to create co-operative and long-term relationships, it must be seen as legitimate. Suchman (1995) defines legitimacy in these terms: “Legitimacy is a generalised perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values beliefs, and definitions” (p. 574).

In their review of legitimacy theory, Tilling and Tilt (2010) create a theoretical framework that has a hierarchy of legitimacy, starting with institutional legitimacy, followed by organisational legitimacy, then phases of organisational legitimacy. Tilling, Tilt and Ackerman (2008) describe institutional legitimacy as “the ‘macro-theory’ of legitimation, [which] deals with how social-institutional structures as a whole (capitalism, for example, or government) have gained acceptance from society at large” (p.2). Companies are institutional “beings” in this sense, because they are the embodiment of capitalism, and themselves “creatures of law”, as artificial persons.

The imposition of Section 172 was placed squarely in the context of societal expectations by Margaret Hodge and the SG, and as we argue below, represents the first of two stages of institutional legitimacy. The goal of company law reform was stated to be “competitiveness and efficient creation of wealth and other benefits for all participants in the enterprise” (Company Law Review, 1999, p. 36). In terms of Section 172, the Government’s White Paper (DTI, 2005) said “The statement of duties will be drafted in a way which reflects modern business needs and wider expectations of responsible business behaviour” (p.20). According to the White Paper (DTI, 2005), these wider expectations include companies creating and maintaining effective relationships with stakeholders, both those who make firm-specific investments, and more amorphous stakeholders such as the community.

So taking the approach of Hybels (1995), who assimilates the resource based view of legitimacy into his model, legitimacy is an intangible concept. However like intangible assets of a company such as brand recognition, which arise as a result of

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consumer trust in a product, it can be measured by the degree of resource flow to a company (Tilling *et al*, 2008), which is then reported on in the Annual Report. What the UK Government has done by including Section 172 in the CA 06, and justifying a change in the focus of directors' duties by reference to changing social norms (DTI, 2007b) is to change the institutional environment in which companies operate.

The effect of that change is to provide an opening to companies to compete for resources in a new manner, one which requires directors to maintain a focus on the "bottom line" of the company, but in doing so, to take into account a wide range of resource providers, and the interests they have in the success of the company. Rather than the UK having an unspoken understanding of what O'Donovan refers to as the, "intangible social agreement or contract between business and society" (2002, p.344), it now has an explicit statement providing that stakeholders are a legitimate part of doing business. As Minister Hodge put it, "Pursuing the interests of shareholders and embracing wider responsibilities are complementary purposes, not contradictory ones (DTI, 2007a, p.2). So to a degree, the intangible has been made tangible. Kostova and Zaheer (1999) would describe this result as a legitimating environment in which companies can practice a type of CSR.

It is therefore arguable that from the point of view of a company director, there is effectively a "win-win" scenario in the new formulation of duties. The SG, and consequently the UK Government, has made Friedman's profit maximisation paradigm the purpose of the company's existence. As Keay (2010) and Johnston (2007) conclude, Section 172 provides the first **legislative** imprimatur to shareholder primacy. In terms of legitimacy, there is no higher level than regulation. Lindblom's "legitimacy gap" (1994) we argue, has now been addressed, in an institutional legitimacy manner, by virtue of this change in law.

However, the subjectivity of the duty is retained, insofar as directors must act in what they consider to be "good faith". When the meaning of "good faith" has been considered judicially, actions of directors have been considered by the Courts objectively, in the light of all the circumstances surrounding those actions. But the Courts are in general reluctant to interfere with the judgement of directors, given the freedom provided by the legislation to apply what is commonly known as the "business judgement rule" (Keay, 2009, Yeoh, 2007).

So it is to be for directors to use their judgment to determine, in any given case, which of the Section 172 factors, if any, are relevant, and to what degree, or whether there are other factors that should be considered. The public is assured that directors will be (or should be) more "inclusive" in their approach to decision making, but the "heart" of the firm is now legitimately and indisputably found in the board of directors. As Lord Goldsmith stated in Parliamentary Debates, "it is for the directors, by reference to those things we are talking about - the objective of the company - to judge and form a good faith judgement about what is to be regarded as success for the members as a whole" (Hansard, 2006a).

Major companies in recent years have used their CSR as a marketing tool to build their reputations and now consequent to s 172 a company must provide information on its policies that affect stakeholders. Cooper and Owen (2007) concluded that this, "enlightened shareholder", or 'inclusive', model did little to enhance corporate

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transparency and, even more fundamentally, it is quite impossible to envisage how stakeholders could have effectively utilised the information provided anyway” (p.666).

In terms of this discussion, we conclude that Section 172 has, in reality, changed little in terms of corporate governance in the UK. Directors have never been prohibited from considering the interests of stakeholders in governing a company, and indeed, were specifically instructed to take the company’s employees into account (Harper Ho, 2010), even if their focus was increasing shareholder value. Nonetheless, the legitimating aspect is in the wording of the section – linking the success of the company with benefits for its members – thus ensuring that directors are clear on what their overall role is to be. So long as they carry out that role properly and reasonably, something that requires consideration of the factors in Section 172, they are as unlikely to be challenged, as was the case under the common law.

3.2 Institutional Legitimacy Justification for the Reporting Obligation

If the first stage of legitimising a shareholder primacy framework for the purpose of a business is found in Section 172, the second stage relates to Section 417, the reporting requirement. We consider that the reporting stage itself has two levels of legitimacy, one which relates to directors, and one which relates to stakeholders, these being two sides of the same coin, so to speak.

Firstly, we argue that under the ESV approach, Section 417 represents the “quid pro quo” of the discretion contained in Section 172. The caveat on the decision making discretion is the report of directors’ compliance with Section 172. The report is aimed, in our view, at validating or legitimising the approach directors take. It is not a complete caveat however, because the contents of the report, like the decision making powers in Section 172, are within the control of directors. Shareholders and stakeholders are generally not in a position to have knowledge of the “inner workings” of the board of directors, so are left in a position whereby they must decide whether to trust the directors. The greater the degree of trust a company creates, the greater degree of legitimacy it obtains, but low levels of legitimacy can result in the company not succeeding to do what it was set up to do (Tilling, 2004).

Thus by recognising that a reporting obligation linked to the reformulated director’s duty is a necessary part of current societal expectations, the Government has provided an institutional legitimacy strategy for companies. Directors have a choice to report in the spirit of the law, and if they choose to do so, they have an opportunity to increase organisational trust and legitimacy, which will have only positive benefits for the company. A specific claimed benefit of this requirement is, “improvement in shareholder dialogue and engagement” (DTI, 2007b, pp.16-17), but given that the report is read and acted on by company outsiders, another benefit may well be increased stakeholder engagement also.

In terms of legitimacy theory, the Annual Report is the appropriate place for this type of disclosure. Suchman (1995, p.576) says that “Within this tradition, *legitimacy* and *institutionalism* are virtually synonymous. Both phenomena empower organisations primarily by making them seem *natural* and *meaningful* “(emphasis in the original).

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Hybels (1995, p.243) stated that, "Legitimacy itself has no material form. It exists only as a symbolic representation of the collective evaluation of an institution". To turn the intangible into the tangible, a company can point to its Annual Report; thus compliance with Section 417 provides an opportunity to argue that the company is able to be aligned with "the larger social system of which the entity is part" (Lindblom, 1994, p.2). This is one way of dealing with Lindblom's legitimacy gap, although it is not the only way, as shown by the number of companies which produce additional CSR reporting.

The reverse argument places Section 417, from the stakeholder's perspective, as a legitimacy strategy. It shows that the Government takes seriously the call for transparency concerning corporate operations, in that it is prepared to legislate for such an outcome. Williams and Conley (2005) quote from the CLRSG Final Report of 2001, where it was said, "Our law should provide the maximum possible freedom combined with the transparency necessary to ensure the responsible and accountable use of that freedom" (p.516).

In effect, the UK Government acknowledged that directors do their job, in the main, out of the public eye, and indeed the reality is that their job is done predominantly out of the eyes of shareholders. So, "Given the unobservability of most organizational activities, external publics [for example, investors, creditors, employees and NGOs] come to rely on words and numbers (i.e. annual reports and financial statements) as imperfect proxies for these activities" (Neu, Warsame and Pedwell, 1998, p.268), and further, "the annual report possesses a degree of credibility not associated with other forms of advertising" (p.269).

In order to grow and compete, companies need firm-specific resources and investment, and stakeholders provide those resources. Thus legitimising in statute the requirement to provide a degree of transparency to those who provide resources to the company is a "win-win" scenario for the Government, especially when combined with the section requiring directors to acknowledge that stakeholders have a role to play in the operations of a company. At an institutional legitimacy level, the environment created provides significant opportunities for companies to obtain organisational legitimacy, and stakeholders to build that organisational legitimacy into their relationships with the company. However with the replacement of the OFR with the BR, there is an issue as to the degree to which stakeholders will accept that the less prescriptive reporting requirements are likely to meet their needs. That issue was considered by Williamson and Lynch-Wood (2008) who suggest that there is likely to be a lesser level of perceived legitimacy with the BR, compared to the OFR. It therefore falls to directors to report in a manner that will best optimise the ability to obtain organisational legitimacy from their stakeholders.

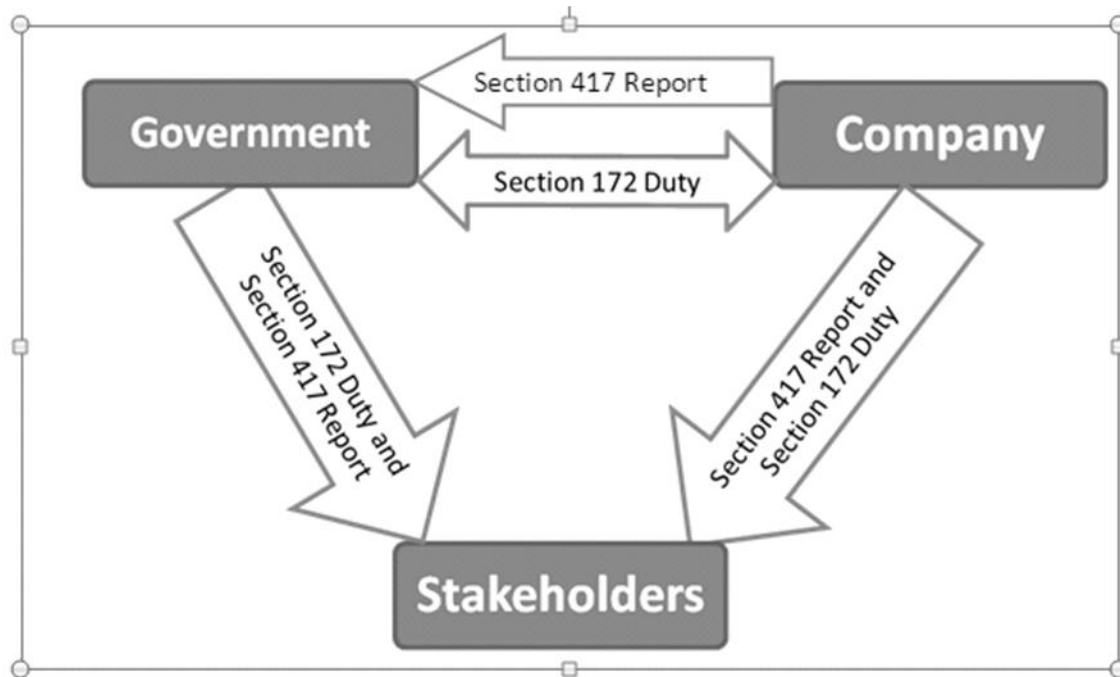
This goal is helped by the creation of a reporting framework that provides for the present and the future – if, as Margaret Hodge suggests (DTI, 2007), social norms and expectations change over time, the BR needs to be flexible enough to adjust to those changes and meet the needs of shareholders and stakeholders at any given time. Hence the provisions of the section are framed in a general manner, and it not expected that any statutory template will be provided. So every company is able to present its BR in the form and format which most closely aligns with the context of its business, as provided by law.

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Our understanding of how institutional theory applies in this context is depicted in diagrammatic form by Figure 1. The arrows represent the directions of institutional legitimacy, and the parties involved in the new environment created by Sections 172 and 417.

We accept that the legislative changes are important, as a statutory recognition of the roles and expectations of stakeholders in terms of business. However, in our opinion, the law as it stood prior to the passage of the CA 06 did in fact provide directors with the same degree of freedom to make decisions and report that they have now.

Figure 1 Institutional Legitimacy Model



Therefore although there is an arguable legitimacy justification for the Government's changes, it is tempered by this reality. In this light, we now undertake a functional, rather than critical, analysis of Tesco's 2008 Business Review, found in its annual report for that year.

4. Tesco PLC's 2008 Business Review

Given the manner of presentation of Tesco's 2008 BR, we considered that the most practical method of analysis against the provisions of Section 417 was to create a check list, based on the requirements of the section. We have followed the structure of the section in creating this checklist, because it appears to us to provide a useful structure for the BR

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4.1 Business Review Checklist

After reviewing the provisions of Section 417 in detail, the headings we consider relevant are:

1. A fair review of the company's business and a description of the principal risks and uncertainties facing the company (section 417(3) (a) and (b)).
 - We interpret this as a summary of the performance for the year, together with forward looking information concerning matters which could impact on the following year's performance.
2. A full analysis of the year's business performance together with year end information on the company's business position (section 417(4) (a) and (b)).
 - We interpret this as summary financial statements, which would include year-start and year-end comparative information.
3. Information relating to the company's future development, performance and position (section 417(5) (a)).
 - We interpret this as forward looking qualitative information which would include measurement indicators against which the following year's results can be compared.
4. Information regarding the company's relationship to its main stakeholders including any policies of the company on those matters and the effectiveness of those policies (section 417(5) (b)).
 - We interpret this as requiring at a minimum identification of stakeholders, a summary of stakeholder engagement, strategies relating to stakeholders, forward looking plans, and identification of negative externalities.
5. Information about contractual relationships which the company considers is essential to its business (section 417(5) (c)).
 - We interpret this to include information relating to the supply chain, amongst other things, and if no information is provided, then an explanation of the lack of information is required, as the Act provides.
6. Analysis of key performance indicators both financial and non-financial (section 417(6)).
 - We interpret this as requiring easily understood data which shows how KPI's are developed, what they are, how they are measured, and how they are changed.
7. Financial information additional to or explanatory of the annual accounts (section 417(8)).
 - We interpret this as being commonly understood information that "translates" financial statements into layman's language.

4.2 Tesco's 2008 Business Report Analysis

The 2008 Directors' Report commences with the following statement. "Business Review: This Business Review analyses the performance of the Tesco Group in the financial year ended 23 February 2008. It also explains other aspects of the Group's markets, results and operations, including strategy and risk management" (Tesco, 2008b, p.3). The BR then starts with the Long-term Strategy of the company, and the commentary notes the inclusion of "the community" in the list of objectives, to reflect "Tesco's long-term commitments on community and environment" (Tesco, 2008b,

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p.3). The total report is 15 pages long, although we did find some of the expected information in the Corporate Governance section of the Annual Report, particularly in relation to stakeholder and shareholder engagement.

Using the checklist above, we easily found the information required for items one, two, three, six and seven (the relevant information is summarised in Table One). There is very little information concerning the company's contractual relationships (item five), and only one heading in the report which contains generic narrative on this point. It is possible to make an informed guess over what types of contractual relationships are important for Tesco from information contained in the report, and other information available on Tesco's website, but there is not even a statement to the effect that the company has determined it is not in its interests to provide that information, for example on the grounds of commercial sensitivity, as we would have expected. Thus Table 1 contains all information which could possibly come under the Contractual Relationships heading.

The information provided for item four is not specifically identified in terms of the statutory requirements (Tesco, 2008b). In particular, we consider that a reader would not be able to identify which parts of the narrative covering stakeholder relationships provide information about the company's stakeholder policies, or the effectiveness of those policies, as required by Section 417(5) (b). The importance of complying with this part of section 417 is in the fact that the reporting represents evidence of the directors' compliance with section 172. What is provided, in our opinion, is simply a list of achievements under a general heading, "Resources and Relationships", all in two pages. The sub-headings in this section relate to the company's self-developed Steering Wheel, which pictorially presents Tesco's strategic framework, rather than the provisions of Section 417(5). Elsewhere it is noted that the Steering Wheel is based on a Balanced Scorecard, and that it provides the framework for the company's key performance indicators (KPI's) (Tesco, 2006a, p.10).

In terms of environmental matters, a single heading of "Environment" is provided. Four separate environmental achievements are noted by way of bullet points. We can directly or indirectly infer the existence of some environmental targets from the narrative, but a reader would not be fully informed as to the total extent of the company's policies on the environment, and the effectiveness of those policies, from reading about four "headline" achievements, three of which would come under the umbrella of "global warming".

The BR does comment on environmental risks, in the Risk section of the report, identifying that stakeholder and expert engagement is important to the development of company policies in this area. The narrative does not provide any detail as to whom the company engages with, and what the outcomes of the engagement are, other than some possible competitive advantage. Readers presumably, must trust that the company has this area under control.

Section 417(5) (b) (ii) considers employees. Rather than one heading with bullet points, there are four separate headings, covering Employees, Employee Share Schemes, Training and Development, and Diversity and Inclusivity. The information under the first heading provides what could be interpreted as a policy: "We are committed to providing market-leading working conditions for our staff and we

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encourage suppliers to do the same” (Tesco, 2008b, p.13). The narrative does not however discuss whether Tesco undertakes a staff satisfaction survey, or if it does, what the results of the survey are. There is therefore no way from this section of the BR to determine whether this policy is effective or not. Further information is provided in the Risk section of the report, where mention is made of staff surveys and performance reviews, as well as the name of the staff development programme, but nothing is stated about measurable outcomes. Thus in terms of employees, we consider that it is not possible to obtain an understanding of the effectiveness of Tesco’s employee policies, something necessary for an understanding of the company’s business operations.

The remaining three headings also imply staff policies, but other than detail as to the value of the employee share scheme, the information is aspirational in nature, rather than specific as to what the policies are, and how they are put into effect on a day to day basis.

The last of the parts of Section 417(5) deals with social and community issues. Under the heading “Community, environment and corporate responsibility” the report states:

People tell us they want us to use our size and reach to be a force for good in society. To help us meet this challenge we decided in 2006 to introduce a new Community Plan. This is part of our Steering Wheel, setting out objectives that the business will deliver. It will ensure we provide the right resources, energy and focus to meet the expectations of our customers and other stakeholders in this area.

We have made significant progress this year on the Community Plan and on our key objectives of being a good neighbour in the communities we serve and being fair, responsible and honest, particularly on the environment. This has been recognised through our continued inclusion in FTSE4Good and Dow Jones Sustainability indices (Tesco, 2008b. pp. 13-14).

This says that Tesco is committed to “doing good”, and some specific examples are given under the heading “Community”, but again, the examples are achievements, the “what” without detail of how and why. Performance of these actions is not analysed, for example by providing year on year comparisons, however some forward looking goals are noted in the report, covering community and environmental targets, relating to some of the achievements under these headings.

One separate heading, “Alcohol” is included at the end of this part of the BR. It implies that alcohol is a serious community issue which Tesco needs to address, and the manner in which it is addressing this issue is set out. We would have thought that rather than a separate item, this narrative would have been included under the “Community” heading, being a matter of social responsibility.

At the end of the Corporate Governance section of the Annual Report, there is comment on stakeholder engagement (Tesco, 2008b, p.24). We consider that this information should in fact be in the BR, given that Section 172 is about the role of

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stakeholders in the business, and Section 417(5) is about reporting on that role. Nonetheless, as no detail is provided, the information can, in our opinion, only be considered aspirational in nature.

Table 1 below summarises our findings.

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Table 1: Findings

Review of the company's business and a description of the principal risks and uncertainties facing the company	Analysis of the year's business performance and year end information on the company's business position	Information relating to the company's future development, performance and position	Information regarding the company's relationship to its main stakeholders including any policies and their effectiveness	Information about contractual relationships which the company considers essential to its business	Analysis of key performance indicators both financial and non-financial	Financial information additional to or explanatory of the annual accounts
<ul style="list-style-type: none"> ➤ Markets served and business model p.3 ➤ Operations, resources and relationships pp 10-13 	<ul style="list-style-type: none"> ➤ Joint ventures and associates pp.6-7 ➤ KPIs pp 8-9 ➤ UK and International operations pp.10-13 ➤ Joint ventures and associates pp. 6-7 	<ul style="list-style-type: none"> ➤ Long-term strategy p.3 ➤ Future development subject to risk management and identification pp 14-16 ➤ Cautionary statement regarding forward-looking information p. 17 ➤ CE statement has forward looking information but this is not in the BR 	<ul style="list-style-type: none"> ➤ Resources and relationships p. 13 ➤ Customers pp. 13 – 14 ➤ Employees p. 13 ➤ Employee share scheme p. 13 ➤ Training and development p. 13 ➤ Diversity and inclusivity p. 13 ➤ Suppliers p. 13 ➤ Community, environment and corporate responsibility p.13 ➤ Environment p.14 ➤ Nutrition p. 14 ➤ Community p. 14 ➤ The year ahead p. 14 ➤ Alcohol p. 14 ➤ Employment Policies and Political and charitable donations are not in the BR 	<ul style="list-style-type: none"> ➤ Information that could be inferred by the reference to the Bank of Scotland p.3 ➤ Joint venture governance and partnerships p. 17 	<ul style="list-style-type: none"> ➤ KPIs p.7 ➤ The year ahead p. 14 	<ul style="list-style-type: none"> ➤ Group performance and Results pp.4-7 ➤ International results pp 4-5 ➤ Joint ventures and associates pp.6-7

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4.3 Discussion

The part of the BR where companies provide the information required by Section 417(5), or explanations for not providing the information is where shareholders and others can assess the directors' performance of the duty in section 172.

Thus the information that would seem to be essential to provide a proper assessment of the "development, performance or position of the company's business" (section 417(5)) should be easily accessible to a reader.

Section 417(6) provides that there should be analysis using key performance indicators (KPIs) and that "KPIs means factors by reference to which the development, performance or position of the company's business can be measured effectively". This includes both financial and non-financial indicators.

The 2006 and 2008 Annual Reports refer to Tesco's self-developed "Steering Wheel" as a management tool which is operated internally enabling Tesco to take into account the needs of stakeholders. Shareholders and stakeholders are presented with a depiction of the Steering Wheel, with the note that it is integral to Tesco's performance of its social responsibility and sustainability goals. These goals are identified in the Steering Wheel, but the means for attaining the goals is missing.

In 2006 the OFR presents some of the KPIs that are tracked through the Steering Wheel, but these are omitted in the 2008 BR. The Corporate Responsibility Review (CRR) for both years has a Steering Wheel and the 2006 CRR asserts that each segment in the steering wheel has a set of KPIs, "which set demanding targets". The performance of the KPIs is reported to the Board and it is the Board that reviews the KPIs to assess whether they are appropriate in terms of meeting the needs of stakeholders. By not including information on the performance and effectiveness of these KPIs in the BR, stakeholders are unable, we argue, to have "an understanding of the development, performance or position of the company's business" as section 417 directs. Section 417 does not prevent directors from creating other reporting documents, but the annual report is, as Neu *et al* (1998) note, the most authoritative source of information available. Thus it is to be expected that there would be compliance, or an explanation of non-compliance with the provisions of section 417. We also consider that two pages in a 15 page report is insufficient to fully present Tesco's social responsibility achievements, targets, and policies to shareholders, and wider stakeholders. In excess of 10 pages of the report deal with the financial performance of the company, either by narrative or tables. Readers would have an excellent understanding of how the company is doing financially, something that is essential in terms of Section 172, which requires the directors to manage the company so as to produce benefits, presumably in the form of dividends, to shareholders. There are also three pages on the risks the business faces, again allowing for consideration of the results, in the light of risk management. There would seem to be a lack of balance in the BR, in terms of the reporting requirements.

Overall, therefore, it could be argued that Tesco is doing its best to provide the information shareholders and others need in order to assess the manner in which Tesco has complied with Section 172. Tesco may well point to much fuller information provided by the company in its CRR, and through its website, but that is

not what Section 417 requires. Nowhere is there a statement in the BR that refers to how the directors have determined to meet their obligations under section 172.

The Board in meeting its statutory requirements has not in reality embraced a wider perspective to consider social responsibility to non-shareholder interests. Tesco's motivation appears to be the need to meet and anticipate broader public concerns which could impact on its financial interests, thus information is included which highlights achievements regarding its environment and community initiatives in its BR. However, there is not sufficient information to ascertain what the company's environmental or community impacts are, or what long term responses to stakeholders are intended.

5. Future Research

Given our findings on the 2008 Business Review, the authors consider that a longitudinal study of Tesco's Business Reviews will be in order. This would, of necessity, include Tesco's reporting prior to s 417 coming into effect, when directors were obliged to report against the more expansive requirements of the OFR. However, space precludes us from doing such a study in this paper.

We would hope to see changes in the Business Review as Tesco appreciates the value of the opportunity offered by the BR to tell its shareholders and stakeholders of its outward looking activities.

6. Conclusion

In our legitimacy model, institutional legitimacy goes in a number of directions, between the three major players, Government, companies, and stakeholders. As argued above, the Section 172 duty, whilst codifying the primary "raison d'être" of the company, also provides a statutory permission to fully utilise the resources that may be available to a company. Stakeholders make firm-specific investments, if they see the company is legitimate, and therefore to be trusted (Tilling *et al*, 2008). Thus, as Neu *et al* (1998) show, the annual report is a particularly important tool in the strategy of shaping public perceptions of the company. Section 417 clearly provides a statutory endorsement of this state, by **requiring** companies to report on their engagement with stakeholders, and the effects of that engagement, in their annual reports. In other words, by appearing to be genuinely concerned with environmental, social and community matters, it is possible a competitive advantage can be gained, which would only enhance the prospects of the company being successful.

Based on our analysis, which we freely acknowledge is functional, rather than in depth, but which would be likely to reflect the type of evaluation a shareholder or other reader would give to the BR, we consider that the company has not used the new statutory provisions to adopt a fresh approach that would maximise its opportunity to position itself in the best possible light with stakeholders. Even so, perhaps section 417 **has** assisted Tesco's Board in identifying areas in which it could integrate a more expansive approach to stakeholders, and the role they could play in generating success for the company. A substantial part of the BR outlines Tesco's awareness of risk and risk management, which integrates Tesco's view of societal concerns with CSR. In doing so, the Board is demonstrating a strategy to maximise

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shareholder wealth, by anticipating and reacting to the public's concerns, actual or potential.

Tesco's corporate performance in respect to its CSR as outlined in the BR increases the legitimacy of its social actions. The company is being responsive to changing community expectations regarding corporate responsibility to non-shareholder stakeholders, and showing that it understands that legitimacy can be lost through continuing with activities which previously may have been acceptable, but are now no longer (Deegan, Rankin and Tobin, 2000). An example is in the issue of prices – Tesco recognises that a balance must be struck by treating suppliers fairly, but in a manner that provides the best possible price point for its customers, which is fair to those customers. The BR is one avenue of communication that Tesco uses to communicate with its stakeholders who are resource providers to the organisation. Tilling et al (2010) assert that, "The communication from the organisation is viewed by stakeholders, and this in turn affects the legitimacy level as perceived by the stakeholders". The environmental and community goals that Tesco sets out in the BR could help to maximise its legitimacy and allow it to achieve its goals. The survival of an organisation like Tesco depends on stakeholders recognising that it is satisfying an economic and social purpose, and its failure could result from stakeholder dissatisfaction. However, as noted above, there is an imbalance in the report with respect to the provisions in Section 417(5), given that financial information and risk management are dealt with fulsomely, but reporting on stakeholder issues is very much less expansive, and does not, in our opinion, meet the requirements of the section.

Our conclusion is that Minister Hodge's celebration of the statutory changes in the CA 2006 may be premature. The intrinsic value Tesco places on its stakeholders is not clear from this report. Information required by Section 417 may well be available in other places, but in our opinion, Tesco should provide more than isolated examples of achievements and engagement with its stakeholders in this report – it is a valuable opportunity to demonstrate the value of stakeholders within the company which should not be lost.

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