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Internal and External Influences on the Firm Objective

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***Abstract*—**Firms are increasingly responding to social and environmental claims from society. Practices oriented to attend issues such as poverty, work equality, or renewable energy, are being implemented more frequently by firms to address impacts on sustainability. However, questions remain on how the responses of firms vary across industries and regions between the social and the economic objectives. Using concepts from organizational theory and social network theory, this paper aims to create a theoretical framework that explains the internal and external influences that make a firm establish its objective. The framework explains why firms might have a different objective orientation in terms of its economic and social prioritization.

***Keywords*—**Organizational identity, social network analysis, firm objective, value maximization, social responsibility.

I. Introduction

DURING the past 30 years, academics have intended to provide answers that extend the purpose of the firm to not only consider economic value maximization but also social welfare as well [11], [24]. Some of these answers have come from a normative perspective, considering that businesses have an obligation to solve social problems since they take resources from society to accomplish their goals [8]. From an instrumental perspective, academics have tried to convey the idea that social participation will generate economic benefits [18], [25]. Finally, from an economic perspective, researchers insist that the best way to serve society is through maximizing shareholder value leaving stakeholders benefits as a consequence of shareholder wealth [15], [24]. These different approaches have failed to provide complete answers for businesses and have fueled a debate on the firm´s objective, since in practice there is a wide spectrum of social outputs from firms. The range of this spectrum goes from those firms which comply only with the minimum requirements of the law, to those which are actively involved and consider the social and environmental as strategic. Some researchers suggest that these inconsistent results might be a product of generalization, meaning that most of the research is oriented to look for a unique and definite answer for the purpose of the firm, ignoring the complexity of the firm's context [3], [21]. The latter is precisely the approach taken in this paper.

The main purpose of this paper is to develop a theoretical framework that contributes to understanding why different firms embrace different degrees of social and economic objectives. Building on previous work by Brickson [7], [22], using concepts from organizational theory and social network, this paper argues that depending on the identity of the organization and the characteristics of its network, a firm will prioritize its economic and social objectives differently. It also explains how characteristics on the structure in the firm´s external groups (stakeholders) can create shifts in the internal identity.

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A theoretical framework that considers internal levels of representation (organizational identity) and external group characteristics (network analysis) will shed some light into explaining why a diversity of objectives can be found in firms across industries, sizes and regions and, as a result, different degrees of social and economic outcomes. Also, the propose framework will explain how external characteristics in the firm´s network influences the firm in terms of shifts in its internal purpose.

This paper is structured as follows; the first section presents some of the discussion around the objective of the firm, identifying different positions around social and economic prioritization. The second section contains Organizational Identity conceptual advancements as well as empirical works relevant to this paper. The third section presents literature on Social Network Theory explaining how this perspective can enhance the understanding of the influences of external groups in the firm objective. Finally, the last section introduces a theoretical framework that combines both Organizational Identity and Social Network Theory, as well as propositions on how a firm prioritizes its economic and social objectives differently and the shifts that occur under different network characteristics.

II. The Objective of the Firm

Since the explosive growth from the industrial revolution, firms have consistently augmented its relevancy on society. This relevancy, derived from an increased size, scope and power, has created greater demands from society expecting business to attain their responsibilities accordingly [13], [14], [17]. As a result, the initial idea that a firm exists solely for the sake of making profits has been constantly widened to incorporate other social concerns. However, this change in the firm purpose has not been as clear as it might be expected.

Trying to shed some light, Barnett [3] explains the heterogeneity in the relationship between profits and social performance. In his work, he states that the firm contextual characteristics influence how social and environmental activities may create economic value for some, while for some others might be a neutral or even negative factor. His main conclusion is that it represents a failure to see social and environmental activities as standardize activities which can offer the same results in every context. Despite these growing ethical concerns, there have been strong efforts to defend the objective that for centuries has been the mainstream thought in business, namely shareholder value maximization [24]. The arguments in favor for this perspective are based on the idea that through a single oriented objective (economic maximization) firms can fulfill their responsibilities to their primary group (shareholders) and that alone is in the best interest of society in general [12], [15], [24].

Opposed to the single economic position as the firm objective, Freeman [10] considers that shareholder value maximization should not be the only business objective but a wider perspective including other groups such as clients, suppliers or governmental institutions. In his 1984 multi-cited work, he proposes an alternative for the business objective challenging the conventional wisdom. His main argument lies on the change in the environment of the firm and the strategic implications that this change has for decision making if it is not fully understood.

Freeman [10, p.25] defines stakeholders as "all those groups and individuals that can affect, or are affected by, the accomplishment of organizational purpose" he continues arguing that "...each category of stakeholder groups can be broken down into several useful smaller categories". These groups in the firm's environment are internal and external. Examples of external stakeholders are clients, suppliers, competitors, the media, local community and environmentalist, while examples of internal stakeholders are considered employees and shareholders. Freeman argues that the interconnectedness between economic and social issues is of a great complexity, and that compromises need to be taken on both sides to evolve business management. This discussion on the objective of the firm has influenced academics and managers equally, from those who believe that social and environmental responsibilities are profit reducing activities, to those who consider that doing business should be doing well also. Survival is in fact a common objective of the firm; however, survival is not necessarily always related exclusively to making profits but also to those activities that guarantee survival and growth over the long term [9]. These problems around the objective of the firm create the necessity for answers as to how firms establish objectives in their activities. This paper uses Organizational Identity and Social Network Analysis to construct a theoretical framework that explains the internal and external influences over the objective of the firm to find appropriate answers to these questions.

III. Organizational Identity

In the past 20 years, the Organizational Identity (OI) construct has become relevant in organizational studies literature [1], [2]. OI is defined as a characteristic that is central, distinctive and enduring in an organization [27], and frequently confused with other related constructs such as organizational commitment and internationalization [2].

Brewer and Gardner [6] suggest in their framework that the for-profit corporation have three identity orientations: 1) individualistic, which refer to firms that consider itself a sole entity, distinct from others; 2) relational, which refers to firms that particularize their relationships with specific stakeholders having more personal and selective relationships; 3) collectivistic, which refers to firms that have a sense of association with a larger group. Some important conclusions of this investigation are that the representations of the self (individualistic, relational and collectivistic) are heavily shaped by the relations with other entities. Also, an interesting conclusion is that a match exists between internal members and external stakeholders.

In posterior work, Brickson [7] constructs over her findings to propose that organizational identity determines the type of relationships that firms will have towards their stakeholders. She proposes that 1) individualistic organizations will create relationships that allow fulfilling their own ends, 2) relational organizations will create dyadic relationships with a genuine interest to benefit specific stakeholders, and finally, 3) collective organizations will create relationships based on the alignment of common interest, highly interconnected with stakeholders and going even further to embrace those of the community. These orientations are important in establishing the firm objective since it explains the influences that each characteristic will present in determining the position between economic, social and environmental commitments. Accordingly, the use of OI allows getting a stronger position to explain the influences from other social participants over the firm´s objective. This idea that the organizational identity could be influenced by the external environment has important implications of the business objective towards economic and social issues. The recommendations of Jones and Volpe [16] can be extended at the organizational level and measure how the organizational network influences the identity of the firm; this is precisely the intention for this paper.

IV. Social Network Analysis

The network paradigm has gained some momentum in current organizational research and as with OI movement. The limitations at the individual level and the increasing complexity of the environment create the necessity for more complete answers instead of isolated explanations on the interactions from actors in organizations [4]. Wellman [26] explains Network Analysis as the description of network patterns that limits social behavior and change. Borgatti and Foster [4] provide a useful set of definitions related to social networks that are related to the approach of this study. First, a network is defined as "a set of actors connected by a set of ties" [4]. Each of these actors (nodes) can take the form of persons, teams or organizations and the connections between them are defined by characteristics such as size, centrality or density.

Previous approaches using institutional theory have intended to shed light on the understanding of organizational behavior. For example, Oliver [20] identified different strategic responses because of institutional pressures, arguing that different strategies will emerge depending on the degree of choice and the proactivity of the organization in response of institutional positions. This is important for the objective in an organization since external pressures, in this case institutional, can shape the decision over the final objective of the firm.

Building over Oliver´s work, [20] uses network analysis to advance stakeholder theory. In his work, Oliver argues that using social network concepts can create a theory of external influences according to the structural characteristics of the organization´s network. Among the characteristics of a network, centrality and density are important concepts to understand the influence over the firm's objective.

Centrality refers to the position of an individual actor in reference to others [20]. In terms of power, the individual in a central position can exert more power from the resources available at this position [5]. Freeman [10] explains how centrality has three characteristics, "degree", which refers to the number of connections an actor has in the network; "closeness", which refers to the independency/dependency of an actor from the rest of its members and "betweenness" refers to the intermediary status that an actor presents in the network. For this paper, closeness is an appropriate measure for centrality since the degree of independency from other actors in the network may influence in the objective of the firm. For example, for firms that are more independent and isolated (low centrality) there will exist less influence from external stakeholders to comply with social problems and environmental regulations.

Density refers to the proportion of network ties in comparison to the totality of possibilities of ties in the same network [23]. The density in a network is important since it allows more efficient communication across the network [22]. Also, since density is a characteristic that permits the dissemination of norms across the network, it generates a more collective environment in the network [19], [20]. Accordingly, the degree of density in a network works as a regulation system of communication and the diffusion of norms in the network.

Rowley [22] argues that the interaction of density and centrality generates differences in the structure of the network which in turn influences the power among the actors in the network. This influence is important because the characteristics of the network can shape the orientation that firms presents towards their economic and social objectives.

V. Influences on the Firm Objective

Each of the two theories previously discussed present useful explanations on how an organization can be influenced in its actions and relationships, both internally and externally. Despite the value that research in both areas have brought individually to the literature, the combination of both approaches can have a major impact to predict behavior of the organization [16]. Furthermore, previous work on these areas has missed the influences that the orientation of the identity and the characteristics of the network have over the decisions made for the firm´s objective. As explained previously, the purpose of this paper is to propose the influences that the internal identity orientation of the firm and the characteristics of the network in which it operates shapes its objective; thus, Fig. 1 presents the six scenarios that result from considering the three Organizational Identity categories: 1) individualistic, 2) relational, and 3) collectivistic and the two characteristics of the network: 1) density and 2) centrality, in which the organization participate more.

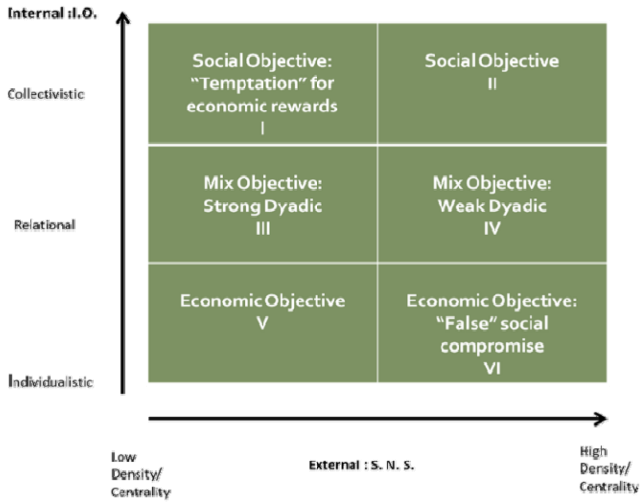

Fig. 1 The objective of the firm scenarios

A. Quadrant I. Social Objective: Temptation for Economic Rewards

The first scenario presents the low density and centrality characteristics in the network with a collectivistic Identity Orientation. Firms in this combination will not prioritize their own economic objective and will be willing to align it with their stakeholders and even with the general community. However, since the density and centrality in the firm´s network are low, there will be no pressures from the actors in the network to influence the firm objective. The firm will be highly independent and the diffusion of norms among the members of the network will be low. This scenario can create temptation to go for more profits since the network will not offer a regulatory environment and the firm could change the orientation to a more dyadic relationship with the external stakeholders.

- Proposition 1: A firm with a collectivistic orientation and a low density/centrality will not prioritize economic objectives and will align it with the shareholders and the community.

B. Quadrant II Prioritization of Social Objective

The second scenario presents the high density and centrality characteristics in the network with a collectivistic Identity Orientation. Firms in this combination will not prioritize their own economic objective and will be willing to align it with their stakeholders and even of the general community. Since density and centrality in the firm´s network is high, there will be high influences from the actors in the network, reinforcing the collective IO. The firm will be highly dependent and the diffusion of norms among the members of the network will be high. This scenario could create a virtuous cycle for social and environmental activities where firms are committed to improve the community's needs. Profits are lower than those with and individualistic objective since resources are allocated to other responsibilities beyond maximizing economic returns.

- Proposition 2: A firm with a collectivistic orientation and a high density/centrality will not prioritize economic objective and will align it with the shareholders and the community.

C. Quadrant III Mix Objective: Strong Dyadic

The third scenario presents the low density and centrality characteristics in the network with a relational Identity Orientation. Firms in this combination will prioritize their own economic objective but will be willing to align it with a few stakeholders based on relationship of cooperation and trust. Since the density and centrality in the firm's network are low, there will be no pressures from other stakeholder groups in the network to influence the firm objective. The firm will be highly independent and the diffusion of norms among the members of the network will be low. This scenario can create strong relationships with those groups among stakeholders that are close to the firm and maximization of profits can take a second place with these groups.

- Proposition 3: A firm with a relational orientation and a low density/centrality network will prioritize its economic objective to the extent that their dyadic relationships allow it.

D. Quadrant IV Mix Objective: Weak Dyadic

The fourth scenario presents a high density and centrality characteristics in the network with a relational Identity Orientation. Firms in this combination will prioritize their own economic objective but will be willing to align it with a few stakeholders based on a relationship of cooperation and trust. However, since the density and centrality in the firm's network are high, there will be high influences from the actors in the network to broaden the dyadic relationships to a more collectivistic approach. The firm will be highly dependent and the diffusion of norms among the members of the network will be high. This scenario could create a false approach for social and environmental activities with those stakeholder groups that are not in the previous established dyadic relationships. Some of the social and environmental activities will be peripheral to the firm objective. Profits may be not affected in the short term but in the long term may diminish from bad firm´s reputation from those stakeholder groups outside the firm's relationships of trust and cooperation.

- Proposition 4: A firm with a relational orientation and a high density/centrality network will prioritize its economic objective to the extent that their dyadic relationships allow it.

E. Quadrant V Prioritization of Economic Objective

The fifth scenario presents the low density and centrality characteristics in the network with an individualistic Identity Orientation. Firms in this combination will prioritize their own economic objective and will not be willing to align it with those of their stakeholders or the general community. Since the density and centrality in the firm´s network is low, there will be no high pressures from the actors in the network if those will want to influence the firm objective for a social or environmental position. The firm will be highly independent and the diffusion of norms among the members of the network will be low. This scenario can create a vicious cycle to go for more profits since the network will not offer a regulatory environment and the firm could try to exploit their resources for more economic rewards.

- Proposition 5: A firm with an individualistic orientation and a low density/centrality will prioritize its own economic objective and will not align it with the shareholders and the community.

F. Quadrant VI False Sense of Compromise

The sixth and last scenario presents the high density and centrality characteristics in the network with an individualistic Identity Orientation. Firms in this combination will prioritize their own economic objective and will not willing to align it with their stakeholders and even of the general community. However, since density and centrality in the firm's network are high, there will be high influences from the actors in the network to broaden the individualistic orientation to a more dyadic or collectivistic orientation. The firm will be highly dependent and the diffusion of norms among the members of the network will be high. This scenario could create a false approach for social and environmental activities, where firms are not committed to improve the community's needs but will pretend that they do. Social and environmental activities will be peripheral to the firm objective and not part of the firm objective. Profits may be not affected in the short term but in the long term may diminish from a bad firm´s reputation among stakeholders.

- Proposition 6: A firm with an individualistic orientation and a high density/centrality will prioritize its own economic objective and will not align it with the shareholders and the community.

VI. Conclusion

There has been a constant debate on whether firms should incorporate social issues to its main objective. Arguments against and in favor of this view have been presented without much explanation of what occurs, which is, firms take different prioritization depending on a context in which they are immersed. The theoretical framework presented here is intended to provide a better understanding on why firms choose different degrees of social and economic prioritization for their objectives and the shifts it endures according to the characteristics of the firm's external context. The relevancy of this theoretical framework is to understand the role that plays the organizational identity and the social network of the firm, especially since pressures from society are increasing for a change in solely economic returns as the objective of the firm. An important contribution of this framework is explaining the internal and external influences for firms in determining their purpose. A clear understanding of these forces can help to redirect the efforts in the attempt for a more balanced perspective between economic and social objectives.

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