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Building Organisational Change Capacity
Public Trust and Corporate Social Responsibility
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Editorial: Change, New Challenges and Achieving Sustainability through Corporate Social Responsibility

Dear Reader,

The Greek philosopher Heraclitus once noticed: 'Nothing is permanent except change.' Today we can say that he hit the nail on the head. One thing that has been constant for years is change; we have seen different forms of change in the environment, people, relations and values and in most of the activity fields our organisations are involved in. All these changes have created new challenges for our people and organisations, to cope with. What has been referred to as economic downturn, recession or even crisis in recent years has created more challenges and intensified the need for new changes.

Today it has become clear that these new changes have to led to sustainable development, moreover we need a shift in mindsets and concrete action towards integrating sustainability at the core of business. Sustainability means corporate commitment to environmental, social and governance issues and should be understood as critical to the organisations' future success.

The UN Global Compact 'Action Plan for Businesses' (2009) finds that restoring confidence and trust requires a shift to long-term sustainable value creation, and insists that Corporate Social Responsibility (CSR) must be an instrument towards this end. In the current issue of EBS Review the authors discuss the topics that are directly related to change, sustainability and coping with the challenges of the present day by looking at organisations in the private and public sectors.

The first paper presents a discussion about organizational change by well-known authors **Anthony F. Buono** and **Kenneth W. Kerber.** In their paper 'Intervention and Organizational Change – Building Organizational Change Capacity' the authors state that although many organisations are faced with the challenge of adapting to rapidly changing, often unpredictable environments, the underlying concept of the change process remains relatively simplistic in nature. The paper explores the need for a diagnostic orientation to conceptualising and implementing change and the concomitant challenge of building organizational change capacity. Emphasis is placed on an intervention strategy focused on: *micro-* (understanding and acceptance of different approaches to change; enhancing willingness and ability to change); *meso-* (creating a change facilitative infrastructure; ensuring appropriate resources); and *macro-* (building a facilitative culture; ongoing strategising) levels of an organisation and the approach is illustrated with a brief case study.

One of the challenges we face today is a challenge of trust. It is undeniable that trust in society matters; it is the glue that holds governments and organisations within a state together and enables a market economy to function. Trust is a social phenomenon that creates and maintains cohesiveness in social systems. Therefore the second paper is about trust. Our long-time partners **David E. McNabb, Gundar J. King** and **Andris Pētersons** discuss the evolution of public trust and social responsibility in the Baltic countries. The authors argue that the range of decision alternatives available to the managers of any organisation is governed by the values that exist at the time the decisions are made and therefore, trust and a commitment to social responsibility are critical values for managers in both the private and public sectors. The paper is a report on a research project to evaluate trends in public trust and responsibility, focusing on two decades of research into public opinion, attitudes, and values towards trust and corporate responsibility in the Baltic States, with a particular focus on Latvia.

The core objectives of their research were to identify, measure, and monitor such operationally important values as trust in government, transformation of economic and social systems after renewed independence, public perceptions of social responsibility programmes and policies for rebuilding and reinforcing public trust. The authors find that the results of the analysis and synthesis of the studies reviewed lead to the conclusion that the economic and social transformation from earlier values and beliefs in the Baltic States is far from complete. Lack of established mutual trust and social concerns, together with the impact of two years of deep economic crisis, have been especially restrictive to further adoption of CSR programmes in the region.

In the current exceptional circumstances, CSR is even more crucial than ever and although it may take more time than we desire, it appears to be true that business leaders are starting to see CSR as a sustainable growth strategy. Nowadays, CSR is an integral part of the business vocabulary and is regarded as a crucially important issue in management. CSR is about the company's accountability to all of its stakeholders, and the more advanced view of CSR demands significant long-term commitment and definition (or redefinition) of corporate values. It can also require wholesale changes to the ways organisations operate and it seems to be a crucial time for people to rethink how we meet our needs today to help to ensure a desirable future for following generations.

We can argue that the same and even stricter principles than CSR in business organisations should apply to public organisations, and accountability and transparency are two major principles of public sector governance to ensure that stakeholders are able to make informed judgements about the performance of the government. We may say that the attention to the relationship between CSR and social capital is a recent development, but it is starting to assume a significant relevance, as social capital is one of the pillars of a sustainable society and it is suggested that governments, local governments and public officials must play their part in achieving sustainability.

CSR covers broad issues including human rights, health and safety, employee welfare, environmental protection and ethics rather than a sole economic focus, therefore it is believed that corporate social and environmental reporting can serve as a useful medium to channel information to social actors.

The next paper 'Budgeting as a Means for Communicating CSR: the Case of the Tallinn City Government' by **Lea Roostalu** and **Mari Kooskora** examines accountability within the local government of Estonia, by exploring the budget books of the Tallinn City Government during the last seventy-five years. The purpose is to determine the effect of CSR orientation on the management information of local governments and find out how the budget books of the city government portray the city's ethical behaviour and CSR orientation, and whether there have been better times for social capital in Estonia. The analysis is based on numerous annual budget books from the Tallinn City Government for 1934–2008 including three periods of the Estonian state: the period of the first independence, the occupation period and the period after the return of independence. The authors analysed and compared the annual budget books of the city government in each of these three periods from the viewpoint of the concept of CSR, transparency and accountability. As a result of the study an original model for measuring changes in

CSR orientation was designed. The authors maintain that the research has explained the central importance of transparency in budgeting to increase the levels of accountability and democracy, and find that taken together, these findings suggest an actual and ever-growing role for new public management in promoting CSR within the community and other stakeholders.

The fourth paper takes us to China where, **Junhong Gao** explores the causes of reputational crises in Chinese organisations, and then defines the connections between these causes and Chinese societal transformation. The author conducted crisis management research in China and 156 Chinese companies were interviewed. These companies are spread over fifty-seven Chinese cities and are active in various industries. Based on the analysis of the interview results, reputational crises were found to be the second most frequently occurring crises among Chinese organisations. The results indicate that reputational crises have various causes, which involve both the internal and external areas of an organisation. The author has uncovered the connections between the causes reputational crisis and contemporary China's transforming environment. A series of implications constitute a practical reference for enterprise managers, especially Chinese enterprise managers when making decisions on an enterprise's development strategy and business direction. Finally, the author suggests that expanding the study to a wider perspective and conducting more empirical research can help draw more comprehensive conclusions.

CSR and innovation programmes are considered among the most important tools for sustainable development. In the fifth paper 'The innovation climate–predictor for Corporate Social Responsibility (CSR)' the authors **Ülle Übius** and **Ruth Alas** investigate connections between the innovation climate and two facets of CSR: the firm's performance concerning social issues and the firm's respect for the interests of agents. The paper is based on a comparative study conducted in Estonian, Chinese, Finnish, Czech, Slovakian and Japanese enterprises. The results of this empirical study show that the innovation climate and CSR were valued differently in those countries as the social, political, cultural, historical and economic environment where organisations operate influences how employees value and evaluate the innovation climate and CSR. The authors suggest that the innovation climate is a complex entity and it predicts the firm's performance concerning social issues and the firm's respect for the interests of agents, therefore, managers should be aware of these influences when they create an innovative climate in an organisation.

The changed environment has brought private and public sectors closer together and this has created new challenges to make the co-operation between two sectors successful and sustainable. Therefore, the topic of public and private sector co-operation has gained the interest and attention of both researchers and governments in various countries for some time already. It is also intriguing to researchers, since a solution must be found for the different interests and needs in the traditional model of social management in order to combine them into a balanced whole. Governments see the implementation of public and private sector co-operation as an opportunity to involve supplementary resources in order to satisfy the rapidly changing needs of society and to accelerate the development of many spheres of community life.

At the same time, governments have to consider many risks, and during stable development, there is a reluctance to take these risks. Problems can arise as a result of the researchers in the field and the governments not having co-operated sufficiently to ensure that the different forms of public and private sector co-operation, which rely on theoretically ordered foundations, and the legal and administrative peculiarities of each specific country are taken into account. Adopting the experiences and actions of other countries without critical analysis can produce the opposite result and create political risks for a government.

In the final paper in this issue we bring you the authors **Maarja Murumägi, Margus Sahk** and **Arno Almann**, who discuss public and private sector cooperation in Estonia, explaining the background and shedding light on perspectives. In their paper, the authors provide a short overview of the main theoretical foundations of public and private sector co-operation, analyse related experiences of other countries and present proposals for the implementation of public and private sector co-operation in Estonia. The authors claim that this topic has not been sufficiently researched in Estonia, and therefore there is no accepted model of implementation for these projects. The main goal for the initial research is to elaborate on the theoretical background of public and private sector co-operation, and establish the main foundations of the implementation model from the legal environment. It is suggested that the next phase of the research will evaluate the outcome of the different stages of the model including the economic and taxpayer perspective.

The authors conclude that in order to successfully carry out partnership projects, a theoretically and methodically well-ordered foundation and well-considered implementation must exist, and suggest that the primary precondition for successful co-operation is the existence of mutual interests at national and local government, as well as private sector levels. Finally they state that although the few public-private partnership (PPP) projects that have been implemented have the possibility to lead to an increase in efficiency and quality in the provision of public services, still the environment for the implementation of PPPs is not favourable in Estonia.

Dear reader, we hope that this brief introduction to the topics of the current EBS Review sparks your interest in the subject matter and articles presented in this issue. As usual all the articles go through a time consuming process of review and evaluation, and the authors often have to rewrite and submit their papers several times before our distinguished editors are satisfied with the results. We consider the topics covered to be important and hope, dear reader, that you can find something interesting to discover. We would also like to show our gratitude to the authors, editors and partners, indeed to everybody who has helped us prepare this issue for you.

On behalf of the editorial board,

Mari Kooskora

Intervention and Organizational Change:* Building Organizational Change Capacity

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Abstract

Although many organizations are faced with the challenge of adapting to rapidly changing, often unpredictable environments, the underlying conception of the change process remains relatively simplistic in nature. The paper explores the need for a diagnostic orientation to conceptualizing and implementing change and the concomitant challenge of building organizational change capacity. Emphasis is placed on an intervention strategy focused on the: 1) *micro*- (understanding and acceptance of different approaches to change; enhancing willingness and ability to change); 2) *meso*- (creating a change facilitative infrastructure, ensuring appropriate resources); and 3) *macro*- (building a facilitative culture, ongoing strategizing) levels of an organization. A brief case study is used to illustrate this approach.

Keywords: intervention, organizational change, change capacity.

Introduction

A basic reality of the 21st century is that organizations and their management are faced with unrelenting demands for change. Companies in literally every industry are increasingly being challenged to both respond to and anticipate continuously changing competitive, market, technological, economic and social conditions to the point where change is described as the "new normal" (Jørgensen, Owen and Neus, 2008). Yet, despite this reality, and a virtual explosion of research and managerial attention devoted to conceptualizing and empirically testing a range of change management practices (cf. Abrahamson, 2000; Armenakis and Harris, 2002, 2009; Beer, Eisenstat and Spector, 1990; de Caluwé and Vermaak, 2002; Higgs and Rowland, 2005; Kerber and Buono, 2005; King and Wright, 2007; Kotter, 1996; Kotter and Cohen, 2002), successful organizational change often remains an elusive quest. A global business study by McKinsey underscores this problem, noting that only one-third of organizational change initiatives were viewed as successful by their leaders (Meaney and Pung, 2008). As a recent IBM white paper study suggests, the "change gap" (i.e. the gap between an organization's expectation of change and its history of successfully managing it) has increased significantly over the past few years (see Jørgensen *et al*, 2008).

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On a general level, managers have grown increasingly comfortable with planned change, as organizational leaders rather than external specialists have taken on increasingly active roles in bringing about change (cf. Aiken and Keller, 2007; Kotter and Cohen, 2002; Nadler, 1988). Indeed, more and more managers have become skilled at reacting to external forces, conceptualizing a preferred future state, and implementing the subsequent "plan" for achieving that well-defined end. In this context, however, change is largely viewed as linear and mechanistic, as a series of discrete and, at times, traumatic events that need to be controlled to enable the organization to achieve its goals. However, given the onslaught of changes that a growing number of organizations now face, this carefully planned, change-specific approach is quickly becoming inadequate as success in rapidly changing environments often demands experimentation, improvisation and the ability to cope with unanticipated occurrences and unintended repercussions (see, for example, Gersick, 1991; Meyer and Stensaker, 2006; Wheatley, 1992). In essence, companies increasingly face the challenge of sustaining continuous movement – sometimes fast, sometimes slow and interspersed with brief periods of constancy (e.g. Leana and Barry, 2000) – toward a largely unknown, emergent future state.

Building a Capacity for Change

The literature offers a number of discussions of "change readiness" – a mental state that typically focuses on the extent to which organizational members' beliefs, attitudes and intentions reflect and recognize the need for a particular change at a specific point in time (e.g. Armenakis, Harris and Mossholder, 1993; Cawsey and Deszca, 2007; Miles, 1997; Neves, 2009; Smith, 1996). As this literature notes, attempts to enhance change readiness encompass a number of factors, including clarifying the underlying message for change (needs, anticipated effects), mobilizing collective support for the change across the organization, and encouraging active participation in the change process.

Since such readiness is seen as fundamental to the successful management of change, and given the constant state of flux in the current business environment, some observers have suggested that it might be more successful to focus on facilitating *continuous* change readiness rather than on implementing and managing specific change efforts (By, 2007; By, Diefenbach and Klarner, 2008). Given this emphasis, it is important to differentiate change readiness in respect to the ability to implement a specific change, from *change capacity* – the ability of an organization to change not just once, but as a normal course of events in response to and in anticipation of internal and external shifts, constantly adapting to and anticipating changes in its environment (see, for example, Klarner, Probst and Soparnot, 2008; Myers and Stensaker, 2006; White and Linden, 2002). Change capacity, which in essence is a broader concept, requires a much more extensive set of interventions. Such capacity implies a focus on multiple, often iterative and overlapping, changes over time, which is different from the traditional view of change as a series of isolated events (Meyer and Stensaker, 2006). Change capacity is thus an ongoing capability that reflects (1) a dynamic process of continuous learning and adjustment, enabling the organization to cope with ambiguity and uncertainty, and (2) the ability to implement those changes (Klarner, *et al*, 2008; Staber and Sydow, 2002).

Drawing on our observations and consulting experience over the past twenty years, the paper focuses on the challenge of building organizational change capacity, enhancing an organization's ability to successfully navigate an array of changes in response to and in anticipation of ever shifting market conditions, customer demands, competitive pressures and societal conditions. As illustrated in Table 1, building organizational change capacity reflects three primary dimensions reflecting change-related processes, an organizational context that facilitates change, and organizational learning (cf. Gravenhorst, Werkman and Boonstra, 2003; Klarner, *et al*, 2008). It requires focused intervention at the (1) *micro-* (understanding and acceptance of different approaches to change; enhancing willingness and ability to change), (2) *meso-* (creating a change facilitative infrastructure, ensuring appropriate resources), and (3) *macro-* (building a facilitative culture, ongoing strategizing) levels of the organization. In essence, building change capacity involves a systemic approach to developing the organization in ways that tap

Table 1: Building Organizational Change Capacity

LEVEL	FOCUS	ILLUSTRATIVE ACTIONS
Micro	Developing an understanding and acceptance of different change approaches	• Adopt a common, enterprise-wide framework for thinking and talking about change • Develop widespread knowledge about different approaches to change and when each is appropriate • Develop deep expertise about change in the organization • Provide change coaching and consulting services • Establish change agent networks to share best practices, tools and insights about changing • Debrief change initiatives with a focus on learning from experience
	Enhancing willingness and ability to change	• Select, hire, evaluate and reward people based on their ability to thrive on change • Form diverse teams to encourage innovation and creativity • Develop, reward and promote supervisors and managers who enable change • Enhance the personal credibility of organizational leaders • Listen to, encourage, and reward mavericks and trailblazers • Create a climate of trust, honesty, and transparency
Meso	Building a change-supportive infrastructure	• Frequent meetings to identify and critically assess opportunities • Encourage low-cost experiments with new ideas • Recognize and reward those who support, encourage, lead and share learning about change • Creation of a fluid structure that allows the easy formation of new groups • Creation of systems to share knowledge, information and learning across boundaries • Responsive and proactive training and education
	Providing appropriate resources	• Designate an owner of the goal to develop change capacity • Devote resources to continually scanning the environment for new ideas • Encourage external contact with stakeholders, especially with customers • Appoint committed change sponsors for specific initiatives • Target key change initiatives with enough resources to get public successes • Shelter breakthroughs with their own budgets and people
Macro	Creating a change-facilitative culture	• Emphasize learning and information sharing • Encourage questions and experiments • Value alternative viewpoints • Tolerate mistakes in the interests of learning • Stakeholder orientation • Shared purpose with a common language about change
	Ensuring ongoing strategizing	• Create a shared purpose • Think dynamically and systemically so that strategies can change quickly • Examine future markets, competitors, and opportunities • Factor future scenarios into today's decisions • String together a series of momentary advantages • Create and communicate a change friendly identity, both internally and externally

into people's natural capacity to change by supporting change and making it a basic part of organizational life.

Intervening at the Micro-level

An important first step in building organizational change capacity is to understand the nature of change and the various ways in which it can be dealt with, with the goal of enhancing the willingness and ability of organizational members to change.

Conceptualizing Different Approaches to Change

From a conceptual vantage point, there are three basic, interrelated approaches to implementing organizational change: directed change, planned change and guided changing (Kerber and Buono, 2005). *Directed change* is driven from the top of the organization and relies on authority, persuasion and compliance. Leaders create and announce the change and seek to convince organizational members to accept it based on business necessity, logical arguments (rational persuasion), emotional appeals, and the leader's personal credibility. Directed change reflects a quick, decisive approach to introducing change in an organization.

Planned change, which has become an increasingly popular approach to change management, may arise from any level in the organization, but ultimately is sponsored by the top. Change leaders and implementers seek involvement in and commitment to the change by making extensive use of specific actions identified through research and experience, which mitigate the typical resistance and productivity losses associated with directed change (e.g. Beckhard and Pritchard, 1992; Beer and Nohria, 2000; Kotter, 1996; LaMarsh, 1995). Underlying most planned change efforts is the Lewinian three-stage process of unfreezing, changing, and refreezing: (1) unfreezing or releasing the organization from its current patterns, (2) transitioning the resulting, more malleable, organization from its current patterns to more adaptive ones, and then (3) refreezing the organization into a new set of patterns by weaving them into the fabric of the organization (Lewin, 1951; Weick and Quinn, 1999). Thus, instead of simply creating and announcing a change, planned change provides a "roadmap" that outlines a project management approach to the change process. It attempts to create the conditions for people to become more involved in the change process, identifying and encouraging key stakeholders to participate in both the form and implementation of the change.

A very different approach to implementing change is *guided changing* – an emergent process that can start at any location within the organization. It is based on the commitment of organizational members and their contributions to the purpose of the organization. In the context of the over-lapping changes that are characteristic of today's hypercompetitive environment, this approach attempts to take full advantage of the expertise and creativity of organizational members, as organic changes emerge and evolve, reconfiguring existing practices and models, and testing new ideas and perspectives. Guided changing is an iterative process of initial interpretation and design, implementation and improvisation, learning from the change effort, and then sharing that learning system-wide, leading to ongoing re-interpretation and redesign of the change as needed. The resulting spiral of learning, innovation and development contributes to both continuous improvement of existing change efforts as well as the ability to generate novel changes and solutions.

As suggested above, each of these approaches has certain advantages, but each one has disadvantages as well. For example, when directed change is used inappropriately organizational members are forced to cope with the well-known and expected reactions of the recipients of the imposed change –

denial, anger, bargaining, sadness and loss (e.g. Kubler-Ross, 1969; Marks, 2003; Nalbandian, 1985). Similarly, while planned change creates an important capability in today's organizations, used inappropriately it can still result in significant reductions in productivity, overwhelm organizational members with its complexity, and alienate key stakeholders as a result of limited participation and true influence in the process. A related limitation of planned change is a lack of flexibility in the face of changing conditions. As experience has illustrated, planned change efforts often constrain the ability of the organization to achieve its intended goals (e.g. Abrahamson, 2000; By, *et al*, 2008; Kerber, 2001). Moreover, the burden for initiating and sustaining the change is still placed directly on organizational leaders, from identifying the need for change and creating a vision of desired outcomes to deciding which changes are ultimately feasible. Finally, our experience suggests that guided changing, if used inappropriately, can contribute to organizational chaos, as continuous changes and transitions confuse and frustrate rather than enlighten organizational members and other key stakeholders. The need to constantly adapt and adjust – the idea of "living in beta" (Wilson, 2008) – can be a daunting experience. A related resource issue is that repeated iterations could easily burn up a fair amount of time and other resources without necessarily "finishing" the process and moving on to the next change. Many people ultimately want organizational change to end, rather than experience changing as a way of doing business that, in essence, never ends.

Acceptance of Different Approaches to Change

Given the reality that each of these approaches has certain advantages and disadvantages, developing true change capacity entails the ability to move back and forth among these change management approaches as dictated by the situation. There are two key factors that influence the appropriateness of each of these approaches to change: business complexity and socio-technical uncertainty (Kerber and Buono, 2005).

Business complexity refers to the intricacy of the system, in essence, the number of different components and the extent of differentiation in the organization in which the change is to be implemented. While there are no precise demarcation points between low and high business complexity, indicators include such factors as organizational size and geographical dispersion, the nature of interdependencies and related technology, the number of products and services, and the array of critical stakeholders. The degree of business complexity increases: 1) the more an organizational change cuts across different hierarchical levels, different work units and different geographic locations; 2) involves reciprocal or team interdependence; 3) affects a range of products and services; and 4) requires the buy-in of a number of internal and external stakeholders. Thus, the focus is on the relative complexity of implementing the change solution and what it will take to successfully introduce and sustain the change overtime.

Socio-technical uncertainty refers to the amount and nature of information processing and decision-making required for the change based on the extent to which the tasks involved are determined, established, and/or exactly known. Some tasks are clearly analyzable, where work processes can be reduced to repeatable steps. In these instances, organizational members can be directed to follow objective, standardized procedures based on technical knowledge and managerial expertise. As the change challenge and its solution become less clear and the appropriate solution is far more difficult to identify, such directed or planned approaches begin to break down. In these instances, there is no organizational repertoire of suitable techniques or procedures, and organizational members must draw on their own judgment, intuition and expertise. While no precise demarcation points appear between low and high socio-technical uncertainty, situations can be described as varying in the extent to which there are (1) clearly known ways to approach the situation, (2) an understandable sequence of steps that can be followed, and (3) an identifiable set of established procedures and practices (see Daft, 2001; Perrow, 1970). In low socio-technical uncertainty situations, the solution to the change challenge is known, while in high socio-technical uncertainty contexts the solution is not known or even fully understood. When socio-technical uncertainty is high, the problem itself is not fully described or clearly understood, meaning that the search for a solution occurs simultaneously with the search for a clear definition of the problem.

When thinking about appropriate approaches to implementing organizational change, the primary driver of the shift from directed change to planned change is increasing business complexity, while the shift to guided changing is driven by increasing socio-technical uncertainty. As the dynamics of a particular situation change – and the relative business complexity and/or socio-technical uncertainty shift – the approach to implementing the change should also evolve. As an example, once an appropriate solution to a guided changing challenge has emerged (in essence, decreasing the socio-technical uncertainty involved), implementation should then shift to either a planned or directed change approach based on the relative business complexity of the situation and urgency of the required change.

Enhancing Change Willingness and Ability

Much like the idea of emergent change itself, it is more effective to have the motivation for seeking out different approaches to change come from the organization and its members. While managers may have the ability to undertake such change, many are often not willing to accept nor are comfortable with the idea of ongoing iteration and improvisation. Thus, in getting managers to think more fully about the challenges associated with organizational change, it is typically most effective to begin where they are likely to be most comfortable – by enhancing organizational understanding of how to successfully lead planned change in their specific context. As part of such discussions, managers typically begin to see the need for a more iterative approach to change as they wrestle with problems and issues that are not clearly defined.

In prompting the reasons underlying their frustration, organizational members typically point to situations from their own experience that start with little more than a general direction, *without* a clearly defined end state, because the solution (or outcome) is generally not determined, established or exactly known. As organizational members discuss the nature of the problems they face, they also begin to question the limits of planned change. One of the ways this process can be facilitated is through an assessment of the nature of the problem the organization is facing (focused on relative business complexity, socio-technical uncertainty and organizational constraints).[1] At this point, it is useful to prompt managers to think about the challenges and skills necessary to "move forward" in dealing with highly complex and uncertain problems – reinforcing the ways in which *business complexity* and *socio-technical uncertainty* shape and influence change management dynamics.

Moving from directed change to planned change to guided changing – and back and forth as needed – involves significant competence transfer from executives and managers to organizational members as the latter become, in effect, the new change leaders. The transition from directed or planned change to guided changing, in particular, can pose a significant challenge for executives and organizational members, who are both accustomed to having the former lead change. While resistance is clearly related to instances where people feel change is being thrust upon them – especially when that change is associated with loss (Nalbandian, 1985) – a downside of carefully orchestrated planned change is that it might create an artificial sense of security among organizational members that could limit reflection (Werr, Stjernberg and Docherty, 1997) and, as a result, suppress the type of learning and improvisation necessary for successful guided changing. Organizational members may also be reluctant to accept responsibility for identifying the nature of a required change – there is a certain comfort in having leaders say, "Here is the problem and the solution." At the same time, one of the greatest challenges to the implementation of this type of emergent, guided changing may be the unwillingness of upper-level managers to let go of tight management control and embrace a messy, dynamic process that can involve the entire organization (Buono and Kerber, 2008; see also By *et al*, 2008).

In an effort to enhance the willingness and ability of organizational members to embrace change, companies can place greater emphasis on selecting, hiring, evaluating and rewarding people based on their ability to thrive on change. As a way of encouraging innovation and creativity, firms can also create and support highly diverse teams – prompting, listening to and rewarding mavericks and trailblazers, so-called "positive deviants" who "transcend the conventional wisdoms, discovering new and innovative ways to function *without* creating conflict" (Seidman and McCauley, 2008). Finally, as part of an effort to enhance the personal credibility of organizational leaders, it is important that organizations create a climate of trust, honesty and transparency. Persuasive and ethical communication is critical, ensuring both the clarity of the message and the honesty and trustworthiness of managers and executives. If organizational members do not trust the change implementer and his or her message, their acceptance of the change is unlikely.

Intervening at the Meso-level: Building a Change-Supportive Infrastructure

Directed change involves telling people what to do and how to do it, with little or no opportunity for input about or modification of the change goal or process. In such instances, the infrastructure supporting the change and the resources that are required for successful change tend to be minimal. Even so, an important dimension of directed change communication is the ability to respond to the "so that" question – "We are changing X *so that* we will be able to accomplish Y" – making certain that organizational members fully understand the reason, rationale and expected outcome of the change (see Ulrich, Zenger and Smallwood, 1999). Yet, while this approach is effective in low complexity/low uncertainty situations, it can severely limit the development of an organization that is faced with more complex and uncertain changes.

In confronting these latter instances, guided changing involves identifying an overall direction and then giving people the opportunity to modify and re-define both the change goal and the change process as needed. For this approach to be successful there must be open and lavish communication across individuals and groups, with flexible systems and processes to allow for and support improvisation and iteration, cross-boundary meetings to identify and critically assess new opportunities, and responsive and proactive training and development that provides organizational members with the requisite skills for such continual learning and experimentation. It is also important to have a sufficiently fluid structure that allows groups to be easily formed and disbanded as necessary, encouraging an open sharing of information, knowledge and learning across departmental and work unit boundaries. Traditional planning and communication strategies, which typically serve as the basic mechanism for work group-related coordination, fall short of supporting the type of dynamic interactions and adjustments that contribute to the ongoing collaboration required for more iterative processes (see Rico, Sanchez-Manzanares, Gil and Gibson, 2008). The infrastructure should also encourage low-cost experimentation with new ideas – sometimes referred to as "no-budget knowledge management" (Hardy, 2007), emphasis is placed on carrying out multiple initiatives that simultaneously improvise, test and iterate solutions and new directions. Once a breakthrough emerges, however, it is important to shelter the effort with its own budget and people.

Within this context, appropriate resources to support the change are critical for such emergent change to be successful. In addition to sufficient time, labor and financial resources, mindshare is critical. When people feel overloaded and overwhelmed by organizational tasks and responsibilities, they are often reluctant to engage in the type of experimentation, improvisation and learning that is characteristic of guided changing. As part of this process, it is also useful to designate an "owner" of the goal to develop organizational change capacity, a role that not only serves as change champion, but also one that can ensure appropriate sponsorship for different initiatives as well. Resources must also be available for continually scanning the environment for new ideas, encouraging contact with external stakeholders (e.g. customers).

Intervening at the Macro-level: Creating a Culture of Change

While organizations typically emphasize stability, predictability and execution, a change-facilitative organizational culture is one that embraces fluidity, openness and learning (see Lawler and Worley, 2006; McLagan, 2003). The ability to break free of organizational traditions and move away from familiar rules and operating procedures, of course, is not easy to do. Indeed, the power of custom and the status quo reinforce cultures that forestall the types of adjustments – especially in terms of agility and flexibility – that organizational members need to embrace in unstable environments (see Thompson, 1994). At the same time, a change-facilitative culture recognizes that more traditional approaches to change may still be appropriate in certain circumstances. It is imperative, therefore, that all organizational members become better informed about the advantages and limitations of different approaches to change as well as the broader context for the change itself as they develop a shared framework for thinking and talking about change. In essence, the organization must strive to create a shared purpose supported by a common language about change.

As part of this process, managers at all levels should be encouraged to embrace a stakeholder orientation that emphasizes learning and information sharing, encourages questions and experiments, values alternative viewpoints and tolerates mistakes in the interests of learning. A focus on simply getting things done – and done right the first time – can quickly crowd out the type of reflection and experimentation that is increasingly vital to success in today's rapidly changing, hyper-competitive environment (see Edmondson, 2008).

A related macro-level factor that affects organizational change capacity involves the organization's approach to strategy. In contrast to traditional approaches to strategy, Lawler and Worley (2006) emphasize the importance of making "strategizing" the normal condition. This approach to strategy involves thinking dynamically, focusing on the future, and stringing together a series of momentary advantages, rather than attempting to achieve a sustainable competitive advantage. Although a high change capacity organization certainly requires a shared purpose to provide overall direction, strategies for achieving that shared purpose can change quickly based on scenarios involving future markets, competitors, and opportunities. Combined with the type of change-facilitative organizational culture discussed above, this dynamic approach to strategizing encourages the organization to keep pace with, if not anticipate, external changes that are critical to business success.

It is important that organizations work to create a shared understanding through which organizational members (1) are encouraged to think dynamically and systemically so that strategies can change quickly, (2) are supported in their efforts to think about future markets, competitors, and opportunities, and (3) are prompted to factor future scenarios into today's decisions. In general, an underlying goal is to create and communicate a change friendly identity both internally and externally.

A Case Illustration: Building Change Capacity

An example of this approach recently occurred in a client organization – a multi-billion dollar global technology leader (GlobalCom) focused on information infrastructure technologies, services and solutions, that was faced with a long-term, complex problem of uncertain dimensions. During a workshop in which different approaches to change were examined, the senior management team wrestled with how to best implement a large-scale planned change that would revamp the process through which GlobalCom's services are delivered to customers. In discussing the business complexity involved in such a massive undertaking, it became increasingly clear that they were also dealing with a higher level of socio-technical uncertainty than initially realized. As they probed the nature of the problem, it became more and more apparent that a planned change approach would fall short of what they needed to do, especially in terms of gathering input from their global field-based workforce, assessing local practices and preferred service delivery strategies, evaluating and assessing this information in light of customer needs and workforce expectations, and determining an appropriate cost structure and level of service uniformity. During the discussion, the group re-visited the idea of guided changing – initial interpretation and design, implementation and improvisation, learning from the change effort, sharing that learning system-wide, then moving to reinterpretation and redesign and so forth – using the iterative process to think through how the new service delivery model could be created and better integrated across all of the key areas of the company. Emphasis was placed on supporting improvisation and shared learning throughout the organization.

As part of their analysis, the senior management team further examined GlobalCom's overall capacity for change, noting that the constraints they were operating under fell short of the change demands of the situation. Based on their continued assessment of GlobalCom's change capacity (drawing on a questionnaire based on the illustrative actions in Table 1), the discussion turned to the meso- and macro-levels and how they could begin to solidify a foundation that would facilitate an organization-wide commitment to an Integrated Services Delivery change as well as other changes that would likely follow. This questionnaire was intended as a "semi-finished" instrument (see Lobnig, 2009) with the goal of stimulating deep, on-going conversations between team members, pushing toward new learning, new mindsets and new skills about change and how they could build greater change capacity within their organization. The underlying objective was to help the management team frame the complexity they were dealing with, assisting them in translating the related uncertainty into grounded, concrete actions.

As others have noted (e.g., Armenakis, *et al*, 1993; Armenakis and Harris, 2009; Gravenhorst, *et al*, 2003), such questionnaires can be very useful in change-related assessments, for discovery as much as confirmation purposes.

Drawing on this assessment, an important part of the senior management team's commitment to the change effort was to develop a plan to track the progress of the change and continually assess the extent to which GlobalCom was building appropriate micro-, meso- and macro-levels of support for the initiative. These assessments would then be used to guide the planning for additional interventions to build the organization's capacity for both large-scale and ongoing change.

Returning to the micro-level, the next step was to create a series of workshops and webinars on "Mastering Change" that would capture this way of thinking, disseminating it to its world-wide workforce, encouraging middle-managers and the field-based service delivery personnel to explore, test and capture leading practices and share that learning on a system-wide basis. The workshops were also used to encourage organizational members to think more analytically about the organizational change challenges that they faced in their work. Participants assessed which approach to change they thought was most appropriate for the challenge(s) they were personally facing. By assessing the relative business complexity and socio-technical uncertainty associated with their particular situation, and the concomitant infrastructure and culture needs at the meso- and macro-level, the managers were quite capable of determining how they should approach the change in question. Discussion also focused on working at the boundaries, as the types of change challenges and strategies often blur together in practice.

At this point, the intervention and process of creating the new services delivery model and way of thinking about organizational change are still in progress. To date, however, workshop participants have reported success in using this approach to conceptualize, plan and implement change within their sphere of influence. With respect to GlobalCom's senior management team, beginning with an understanding and application of planned change, where they initially felt most comfortable, they began to realize *from their own experience* that planned change, while necessary and effective in many situations, was not necessarily sufficient for all situations. At the same time, they realized that as the plan for the new integrated service delivery system was created through this iterative process, once the uncertainties were resolved it would most likely take a planned change approach to ensure world-wide implementation, with the need to continually revisit possibilities as their markets, resources and customer needs continued to evolve. In essence, they foresaw an ongoing iteration between guided changing and planned change in formulating new approaches and ensuring their implementation on a system-wide basis. Through their analysis, the senior management team also began to realize that the ability of the organization to accept and implement these different approaches to change required appropriate resources, a change-supportive infrastructure, and a culture that emphasized the importance of ongoing strategizing and changing.

Intervening to Build Change Capacity

Organizations and their management are quite capable of creating a sustainable foundation for implementing change if they focus the appropriate attention and resources on enhancing their change capacity. As discussed in this paper, this effort requires focused intervention at the micro-, meso- and macro-levels of the organization. Based on the framework presented in this paper, our experience suggests that once organizational members begin to understand the various approaches to change and the concept of organizational change capacity, they are quite capable of determining the appropriate change approach – moving back and forth between directed and planned change and guided changing as necessary – *if* given the opportunity and support.

The approach and intervention described in the paper helped GlobalCom's senior management team to (1) appreciate the complexity and uncertainty of the task they were facing and (2) understand that the complexity and uncertainty surrounding that task required a more patient and involving approach to the change process than they had utilized in the past. More often than not management teams approach highly complex and uncertain tasks with the same mindset and approach they "always use," which often leads them to underestimate the difficulty of the resultant change and, as a result, under-resource the change in terms of time, money, support, and so forth.

As one moves from directed change to planned change to guided changing, however, managers must be willing to give up control based on rules, procedures and tight supervision and substitute an approach based on overall direction, principles, values and commitment. At the same time, as the socio-technical uncertainty involved in the change is gradually resolved, organizational members must be willing to accept follow-on planned or directed changes as dictated by the business complexity and urgency involved. A shared purpose, supported by a common understanding and language about organizational change, can readily facilitate such transitions.

Unfortunately, organizations are all too frequently overly constrained by infrastructures, cultures and strategies that are based on needs for control and predictability rather than what is required by the rapidly changing environment. Companies and their management, however, can no longer afford to rely on ad hoc approaches to managing change that are controlled from above, in essence creating "self-sabotaging traps" that undermine their ability to effectively bring about necessary changes in their organization (cf. Edmondson, 2008; Jørgensen *et al*, 2008). The key is to encourage and support managers to broaden their change implementation repertoire by developing a common understanding of the dynamics of organizational change, building a change-supportive infrastructure, and creating and nurturing a change-facilitative culture. Although successful organizational change may seem to be an elusive quest, the ability to execute change on a sustainable basis is an achievable goal if organizations and their management invest in developing their change capacity.

Notes

The authors have developed two diagnostic questionnaires to facilitate the analysis discussed in the article, based on (1) the complexity, uncertainty and organizational constraints involved in a particular change and (2) the micro-, meso- and macro-factors involved in building organizational change capacity (based on Table 1). Both are available upon request from the first author.

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The Evolution of Public Trust and Social Responsibility in the Baltics

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Abstract

The range of decision alternatives available to the managers of any organization is governed by the values that exist at the time the decisions are made. Therefore, trust and a commitment to social responsibility are critical values for managers in both the private and public sectors. This paper is a report on a research project to evaluate trends in public trust and responsibility, focusing on two decades of research into public opinion, attitudes, and values toward trust and corporate responsibility in the Baltic States, with a particular focus on Latvia.

The core objectives of this research were to identify, measure, and monitor such operationally important values as trust in government, transformation of economic and social systems after renewed independence, public perceptions of social responsibility programs, and policies for rebuilding and reinforcing public trust. The results of this analysis and synthesis of the studies reviewed leads to the conclusion that the economic and social transformation from earlier values and beliefs in the Baltic States is far from complete. Lack of established mutual trust and social concerns, together with the impact of two years of deep economic crisis, have been especially restrictive to further adoption of Corporate Social Responsibility programs in the region.

Keywords: corporate social responsibility, managerial values, public opinion and public relations in government and business, business policy and practice, Baltic managers and students; Latvia, Estonia and Lithuania.

Introduction

Trust in society matters; it is the glue that holds governments and the organizations within a state together and enables a market economy to function. It is a social phenomenon that creates and maintains cohesiveness in social systems. Trust has been found to be associated with productivity, cooperation, conflict, group performance, relations between managers and workers, satisfaction, leadership, stress and burnout, and job satisfaction, among others. In

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organizations, nothing happens without trust (Carnevale, 1995). Trust affects all types of relationships, including those between citizen and citizen, citizen and government, worker and industry, and industry and community. Organizations in a society are responsible for generating and maintaining trust among the polity.

Trust and responsibility in organizations functions on two closely interrelated levels: internal and external organizational structures. Internal trust is established by the actions and operational philosophy of managers; it is then manifested in the way that the organization elects to perform its mission, how managers guide the use of resources, how they respect and treat employees, and how ethical standards are implemented. External trust is a reflection of the ways that forces in the external environment are permitted to influence the transactional policies that are established and exercised by management.

These forces are gradually being shaped and reshaped by the evolving economic and political environments, and the ethical ethos of the period. These forces frame the direction and limits of choice exercised in all dealings with external stakeholders. For example, a government that accepts corruption and malfeasance generates similar de facto behavior in managers of private organizations. When corruption is the social norm, private organizations have little rationale for adopting ethical precepts.

In Latvia, indeed in many countries formerly under soviet rule, managers in public and private organizations are increasingly hampered in their range of operational choices because of the breakdown in morality and trust within both the internal and external operational levels. This breakdown continues to erode the level of trust that citizens hold in their social institutions. Growing dissatisfaction and distrust are, in turn, placing greater pressure upon leaders of local private sector organizations to change the way in which they function. These conditions have resulted in what a growing number of analysts have labeled a *crisis of trust* (Hoffman 2006; Hansen 2005; Young 2004; Millstone and Zwanberg 2000; Cohen 1996).

Declining trust in government, economic and social institutions is not destined to remain the social norm, or to lead to a complete breakdown in existing social systems. In younger democracies, managers are often unwilling or unable to make the hard choices that become necessary in times of severe economic or social stress. The governments of Latvia and, to a lesser degree, Estonia and Lithuania, have had this brought painfully to their attention as they faced the need to implement painful fiscal adjustment during the fiscal crises of 2008 and 2009.

Recognizing the Need for Change

An increasing number of global leaders in government and industry now realize that it is no longer possible to function in the management styles of the past (Streimikiene *et al.,* 2009). In an effort to close the gap extant between professed institutional morality and the implementation of ethical standards, a new organizational policy has emerged. Increasingly, organizations are implementing *Corporate Social Responsibility* (CSR) programs to as part of their efforts to rebuild public trust in the political and economic systems adopted after the breakup of the previous command and control system. CSR is as important to governments as it is to business. Many of the human rights recognized in democratic societies actually reflect public interest and obligations to reduce such social costs as the consequences of injured health or unemployment. Indeed, social capital is the currency of successful operations during economic crises as citizens are asked to make greater and greater sacrifices. Economic fluctuations affect not only the levels of social capital, but also the value of all capital assets.

International standards for CSR have been adopted by the United Nations (UN), the Organization for Economic Cooperation and Development (OECD), the International Labour Organization (ILO), and the European Union (EU). The United Nations has been particularly active in coordinating private sector CSR activities and sustainable development programs. The UN defines CSR as "a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives" (UNIDO 2009).

The UN's Global Compact (GC) was established in 2000 as the coordinating vehicle. The GC is a voluntary initiative that brings together businesses, civil society and international labor organizations, governments, colleges and universities and other stakeholder groups in local networks to devise and implement programs to advance human rights, worker protection, environmental protection, and anti-corruption activities (Ko, 2000; Streimikiene *et al.,* 2009). As of 2005, 45 Lithuanian and 15 Latvian and zero Estonian enterprises had signed the Global Compact Agreement.

This paper examines the relationships uncovered in research studies conducted by the authors at different times over the past two decades, including a more-detailed discussion of perceptions of the extent to which CSR policies and procedures have or have not been adopted by business and industrial organizations in the three Baltic nations. The study reviews three streams of research on these and related themes: (1) a body of management attitudes research carried out by King *et al*. (1994) in which the authors identified and measured important personal values; (2) a longitudinal study carried out by McNabb to measured and monitor changes in trust in such dimensions as political leadership, society in general, and in trust in the economic future of the Baltic states (Ramalgia and McNabb, 2004; McNabb and Jansins, 2008); and (3) the most recent research project to analyze the findings of a review of the extent to which CSR initiatives exist in the business and industry sectors in the Baltics (Pētersons and King, 2009; Pētersons, 2008).

Definitions of Core Concepts

The researchers first defined the concepts of trust and corporate responsibility. Trust has many meanings, but in our research trust is the faith or expectations held by society that the decisions of our political and economic leaders and the actions of our social institutions will be based on honest, dependable and ethical intentions, with the best interests of society at large. When we say we trust government we mean that we believe and expect that those upon whom we depend for the welfare of our society will always act in ways that reflect the broadly shared norms of good behavior, the interest of the community above self interest, and accept responsibility for the elements of society unable to fully fend for themselves (Koehn, 1996; Ramalgia and McNabb, 2004).

Our definition of corporate social responsibility is a product of many different sources, among which is the John F. Kennedy School of Government at Harvard University, which has adopted the following definition:

> Corporate social responsibility encompasses not only what companies do with their profits, but also how they make them. It goes beyond philanthropy and compliance and addresses how companies manage their economic, social, and environmental impacts, as well as their relationships in all key spheres of influence: the workplace, the marketplace, the supply chain, the community, and the public policy realm. (KSG 2007)

Expanding on its formal definition, the Kennedy School noted that a number of related terms have often been used interchangeably for CSR, all of which point in the same direction: the social roles that are expected of private companies in addition to their economic roles. These related terms include:

- Corporate responsibility
- Corporate citizenship
- Social enterprise
- Sustainable development
- Triple-bottom line
- Corporate ethics
- Corporate governance

Government directives for corporate social responsibility are becoming accepted policy in governments as well as strategic directions in business. For example, the UK government, among others including the EU and UN, has established a formal CSR office that is associated with its emphasis on sustainable development. The UK office defines CSR as: "the business contribution to our sustainable development goals."

CSR programs and procedures in the UK are about how business takes account of how its operations impact the economic, social and environmental aspects of society, thus "maximizing the benefits and minimizing the downsides" (CSR-UK 2004). Company CSR programs and procedures are seen as the body of voluntary actions—beyond any legal or political requirements—taken by businesses to integrate their competitive interests with those of the greater society.

Building on these and other contributions, we have adopted the following definition for this paper:

> CSR is any deliberate but voluntary ethical and legal action that is taken by any business enterprise or nonprofit organization to improve its own operations and profitability and better balance internal and external operating costs, while also maximizing the social and economic benefits resulting from its operations.

CSR and Trust

Clearly, corporate social responsibility programs are meaningless unless an ethos of mutual trust exists in society. The social contract that exists between buyers and sellers is built upon a foundation of trust, and is manifest in a general rejection of the once-common policy of *caveat emptor*. If a firm, a political leader, or a business manager is distrusted, all the CSR in the world will be little more than fictional public relations rather than honest communication. Distrust holds back education, shrugs off ethical behavior, and severely limits social relationships. Therefore, this paper begins with discussions of studies conducted by two of the authors to measure trust and attitudes on a number of different dimensions. It then turns to a review of the extent of CSR initiatives extant in business and industrial communities in the Baltic States.

Finally, in addition to identifying and measuring citizens' attitudes and trust in their government, and social and economic institutions, the data gathered over almost two decades of research suggests a possible rationale for the slow adoption of corporate social responsibility concepts. Our findings also suggest that a solid first step may have been taken by private sector organizations toward greater adoption of programs to reduce, if not eliminate, consumer and citizen distrust by becoming more proactive in building mutually beneficial relationships with the public.

Research Objectives

In many if not all of the Central European states that have re-emerged from Soviet domination, a lack of trust has continued to plague economic and political transition. Political decisions are often unduly influenced not only by the collapse of the command and control economic and political systems, but also by the existence of long-held, ethnic-group differences in traditional values and mores. Unusual combinations of traditional Nordic- and Soviet-instilled beliefs and institutions have greatly influenced values in the Baltic nations (Inglehart, Basanez and Moreno, 1998).

In designing this study, our research question focused on determining whether the core values believed to have shaped the formation of the economic and political character of the Baltic States during the first decade after the return to independence might still be seen in the slow record of adoption of CSR by businesses and industries. In the absence of any pre-determined metric applied over the base period studies consulted in our analysis, our interpretation and conclusions have necessarily been qualitative rather than quantitative. However, all three studies consulted in this analysis were conducted following generally accepted random sampling and statistical analysis procedures.

The first objective for the study was to form a benchmark foundation of private sector attitudes and opinions held by interested stakeholders. A stream of research conducted by King *et al*. in the middle of the 1990s was analyzed for this purpose. Important elements of then-extant values were clearly established by the series of studies on managerial values in the Baltic States and Poland after the collapse of Soviet rule.

Our second objective was to review the relevant trust attitudes and values of young adults from the three Baltic States monitored over several years by McNabb in the early 2000s. The time-series metrics were interpreted as trends at the level of the trust held by the subjects in their political, economic and social conditions and institutions. The research design followed was a longitudinal study of the attitudes and opinions of business and economics university students from Estonia, Latvia and Lithuania in a set of studies addressing universal concepts of public trust. These measurements McNabb gathered over a five-year period and published with joint authors in 2004 and 2008.

The third objective related directly to the research question: did the relatively slow adoption of CSR principles and practices reflect previously measured low levels of trust in government, industry and other social institutions? The data for this section of the analysis came from a comprehensive survey by a team led by one of the researchers of attitudes and opinions held by a large sample of business and industrial managers towards CSR (Pētersons and Pavāre, 2005; Pētersons and King, 2009).

Descriptions of the research findings for each of the components of this analysis are reviewed in the next three sections, with greatest emphasis placed on the CSR survey conducted by Professor Pētersons. These analyses will be consolidated in the conclusion with our findings regarding the research question.

Comparing Management Values

The first research objective involved a review of studies conducted in the Baltics by Professor Gundar J. King and his associates in the early 1990s, in which they identified business-related values held by Russophone and other Baltic managers, (King *et al.,* 1994). The sample findings were deemed to be adequate for a characterization of the principal orientations of managers in Estonia, Latvia, and Lithuania. A 66-item Personal Values Questionnaire (PVQ) developed by England and analytical methods developed by Whitely were used in the research (England, 1975; Whitely, 1979).

The Russophone managers in the capital city of Riga turned out to have orientations that were pragmatic, moralistic, affective, or mixed. In comparison, Latvian managers located outside of Riga were less likely to be pragmatic (16%) or moralistic, and, instead, to be more affective. Estonian managers were far more pragmatic, and Lithuanian managers were more moralistic. Previous studies internationally found more pragmatists in Japan, the United States, and Korea,

Trust had the highest (11^{th} of 66) operative value in Estonia, where 37% of the sample evaluated considered it important. The trust concept received the lowest importance rating among Russophones in Latvia (58th of 66). Lithuanian managers placed trust 9th in importance; Ethnic Latvian managers rated it a very low 23^{rd} in importance. The examination of values held by both Latvian and Russophone managers in Latvia revealed the existence of a deep crisis of trust in the business communities.

Concern for social welfare was very high (2^{nd} of the 66 concepts evaluated) among Lithuanian managers, but relatively low among the others: it was rated 36th in importance in Estonia, and rated 40th by the Estonian sample. Latvian managers placed social welfare lowest in importance (49th).

Profitability was the highest operative value of the Russophones (73% of the total manager sample gave high ratings to this concept). High productivity was most important to Latvian managers, and achievement-related skills were rated first among Estonian managers. Lithuanians rated management skills most highly.

In 1998 and 1999, King led a study of values held by business administration students in two regional academic institutions: the Stockholm School of Economics in Riga (SSER) and the University of Latvia (UL). Both schools were considered to be important sources of management ideas and talent emerging in Latvia despite relatively small enrolments in business departments at the time (King *et al.,* 2000).

The England PVQ instrument in the first student survey was also used in this follow up study. This study was supplemented by international comparisons (King and Barnowe, 2003). The multiple purposes of these studies included the identification of values held by students at the beginning and at the end of their studies. Compared to an earlier study (King *et al.,* 1994), important value differences were revealed in the results of the two studies. Cooperation was highly rated by both new and graduating students of both schools. Trust was a highly operative (6th of 66) value among the UL seniors. At SSER, trust was ranked 19^{th} by freshmen and 15^{th} by seniors. Other values were congruent with the educational purposes of both institutions, and generally resembled those found in the West. Although trust was again reported to be an important value, results of the follow-on survey suggested that similar samples believed that "most people can be trusted"

King *et al*. analyzed the local results with those from similar studies in other regions. Overall, the highest level of trust was reported among Norwegian business students, with 56% of the respondents agreeing with the statement that most people can be trusted. The Norwegian sample finding was followed by Estonians (53%), Swedes (48%), Latvians (39%), Lithuanians (38%), and Poles (32%).

In another important concept, most of the composite sample respondents indicated a strong preference for a consultative management style: Swedes (74%), Latvians (58%), Norwegians (57%), Lithuanians (46%), Estonians (45%), and Poles (37%). It is important to note, however, that these differences could also be a reflection of the system and conditions in various academic institutions, subjects' educational objectives, and economic, social and political environments.

Qualitative comments from key informants in the Baltic States suggested that important issues were not covered in the surveys. For example, the surveys did not reveal the conventional wisdom that gives Estonian students their strong drive to seek new opportunities, the Latvian distaste for aggressive marketing, or the influence on Lithuanians of the strengths of their communities.

The surveys clearly revealed the rising influence of trust and mutual cooperation among business students. Promising as their attitudes toward trust were, it was regrettable that it would take several years for these students to become more influential leaders. Following graduation, most students would first work with managers with more established negative mindsets. The exception was provided by the SSER graduates who tended to work with international enterprises, where modern values were embedded. Even with these promising winds of change, the social responsibility transformation of Baltic business communities in light of the diverse Baltic environment was not likely to be easy or very predictable (Barnowe and King, 1997).

The study findings suggested that the transformation process still faces a number of major barriers, and that much of the problem may still be centered in governments' actions rather than in business and industry. For example, an Open Society Institute (OPI) 2002 study for the United Nations Public Administration Network (UNPAN) described corruption as still a major problem in Latvia, although less so in Lithuania or Estonia. While Latvian entrepreneurial managers had earlier been described by the UN as selfish, autocratic, uncooperative, socially poisonous and rapacious, the OPI study indicated that corruption today is far more problematic in public administration than in the private sector. As a result, the most recent anti-corruption legislation has been directed at dealing with this problem. Corruption in public procurement was identified as one of the country's most corrupt spheres. The World Bank and other organizations found the customs administration to be the most corrupt institution, followed by traffic police and the State telephone monopoly *(Lattelekom)*, the government in general, parliament, the police, and the courts. Similar accusations have been directed at all the former Soviet republics.

The Role of Trust in Baltic Society

Trust is often seen as an essential element of social capital and an organizational resource (Barnowe and King, 1997; Fukuyama, 1995). A crisis of trust limits the effectiveness of politics and government, business and industry, the church and the media, science and health services, education and voluntary nonprofit organizations, and all types of institutions around the globe. Because of distrust, the ethos of social responsibility that makes it possible for society to function has been severely strained in many private and public organizations.

Trust is constantly shaped and reshaped by the changing attitudes, intentions, and actions of governments and citizens that affect society. Importantly, trust can also be shaped by public opinion. Because trust is associated with values held individually and collectively, it can be increased easiest where it fits strongly held values. Conversely, it is very difficult to build trust when it goes against the grain of well-established beliefs and social behavior norms. In 2001 and 2005, McNabb conducted two studies of the levels of trust held among samples of Estonian, Latvian and Lithuanian business school students and graduates. The focus of that survey was trust in post-Soviet society, with a special emphasis on measuring changes in trust for state local and national political institutions and policies (McNabb, 2004; McNabb and Pratt, 2008). The two samples of about 100 students each were accepted as adequate for a substantial statistical factor analysis and general conclusions. However, the individual country-group subsamples were considered too small for reliable inferential portraits of the three Baltic State ethnic categories and their subgroups within those subsamples.

In line with the objectives of the study, the responses to a 45-item questionnaire developed by McNabb were divided in five composite factor categories: Trust in Government, Social Capital, Social Networking, Political

Table 1: Scales and Index Scores on a Survey of Social Attitudes

	N	Base Year Index Value	Minimum	Maximum	Mean	Std. Deviation
Composite Trust Factor	96	56.6550	1.22	3.67	2.2662	.45298
Composite Citizenship Factor	96	60.9125	1.70	3.10	2.4365	.32739
Composite Government Factor	94	60.1075	1.25	3.50	2.4043	.42535
Composite Trust in People Factor	95	55.7025	1.33	3.00	2.2281	.33778
	92	71.2175	1.92	3.83	2.8487	

Effectiveness, and Faith in the Future. Index scores were calculated for each of the composite factors to help measure change over time (Table 1).

Attitudes of trust in government, with a composite eight-item scale for the base year of 2.3238, were not encouraging. Most negative was the attitude that the politicians were interested in themselves and not the public. Other responses suggested that the benefits of accession to the European Union, if any, were not widely shared, but accrued to a few powerful people that run the government.

There was little social capital evident in responses about trust in others. The statement "People soon distrust others" with a mean score of 2.11 declined to 2.05, was the most negative expression in the social capital category. Subjects' perceptions relating to social networking were at or near a moderately positive level. Most distrusted were strangers; it was generally felt that "too many people were just out for themselves."

With respect to political effectiveness, only one statement originally received a score higher than 3.00. This was about interest in local elections. It declined from 3.13 to 2.03 in the follow on survey. Responses to two statements indicated that the "public has little control over what the politicians do in office "(declining from 1.92 to 1.81), and that the average person has little influence on government decisions (declining from 1.86 to 1.68).

With respect to their expectations of their country's future, the students expressed confidence in continued progress. It was noted, however, that there was an unusual variability in answers in this category. In retrospect, it suggested that Estonians and Lithuanians were more justified in their optimism. Seen separately, optimism may have been related to a very high economic growth in all three Baltic countries at the time when the latest survey was conducted.

Russophones and their closest colleagues. They are a major source of distrust. The values of economic and political rulers in Latvia appear to be skewed most toward personal gain and power as the most important values. As economic, political and various socially important issues wax and wane in prominence in these interdependent societies, this situation raises important questions about the present and future collaboration of private and public sector leaders in Latvia.

Implementing Corporate Social Responsibility

Andris Pētersons of the Turība School of Business Administration (TSBA) in Riga carried out a research program sponsored by TSBA and the Latvian business community. At the core of the program was a large field survey of business organizations sponsored and supported by TSBA. This survey was designed and conducted over three years from 2003 to 2005 (Pētersons and Pavāre, 2005) using traditional survey methods. The next phase involved a review and analysis of the 987 survey responses, additional investigations in the field, focus group interviews, and supplementary research in Latvia and in the United States (Pētersons and King, 2009). Among the last stages of the study was an exploration of the state of CSR in 50 Latvian companies (Pētersons, 2008).

In many countries, public opinion often associated with publicity about unethical or irresponsible business decisions increases social pressures that can accelerate regulatory and preventative legislation. Moreover, the global nature of modern business firms helps to introduce social values held by managers of international firms.

On the other hand, when operating globally, the few published reports of an action or policy take much longer to reverse results from the unfavorable attitude or undesired activity. As a result, at least some enlightened leaders of business and other organizations are accepting the position that corporate social responsibility and maintaining socially responsible behavior is to their long-term advantage. They recognize that they must work at being good citizens all the time, in all that they do, and with all they interact with and turn to, and this must include social responsibility as a strategic component of their operations.

Empirical in nature, the ongoing studies by Pētersons and his research associates were designed to develop a complete picture of social responsibility programs in the Baltic States, with particular attention on Latvia. Other objectives include a review of the evolution of CSR, identification of the personal values involved in implementing CSR, and determination of the related economic costs and benefits of CSR implementation. The data gathered for this study was reviewed together with contextual observations, a review of CSR-related literature, and selected personal interviews in Latvia and abroad. The conceptual background was developed with the help of a review of published sources in English and Latvian languages.

Using the cluster sampling method, the survey used mail questionnaires sent to 3,976 of the 150,000 enterprises in Latvia. Respondents were randomly selected from mailing lists maintained by sponsors of the survey. About half of the recipients were business executives or owners; the other half represented stakeholders across the general public – 987 businesses responded to produce a rate of return of a relatively high 53.67 percent. There was a higher rate of responses from businesses with 200 or more employees, and a lower rate from small and medium sized businesses. Limited follow-up interviews established the high probability that representatives of smaller business did not respond because they felt the survey not relevant to them, or because of their own lack of understanding or involvement in CSR, or both.

Findings: The State of CSR Knowledge

In Latvia during the last fifty years of the last century there was a growing realization that increased domestic and international economic interdependence was likely to require change in many local operating policies. Following the ideas of the Riga-born British philosopher Sir Isaiah Berlin (Berlin and Hardy, 2001), it was felt that whatever changes were adopted, they should reflect a tolerance of diversity and be optimally pluralistic. Latvian ethical behaviors, often seen as confused, conflicting, and uncertain, are partly guided by traditions, partly distorted by a collective memory of alien overlords, and partly influenced by the negative results of early industrialization.

The business successes reported in Latvia are still measured in the simple terms of growth in production, new technology, and accumulating profits. As a consequence, new entrepreneurs have not related well to calls for balancing their economic objectives with costly actions designed to reflect a commitment to conscious social responsibility.

It is often believed that Latvian sentiments of personal and social responsibility are rooted in the traditional paternal ethics of independent farmers, artisans and entrepreneurs. These perceptions of essentially self-sufficient small business owners allowed for neighborly, cooperative collaboration, but were in conflict with the collectivist values acquired over fifty years of Soviet totalitarian rule. This event was most likely the most important, general influence on the evolution and the state of social responsibility and trust in Latvia. Totalitarianism, along with colonialism and genocide, has been recognized as one of the three most tragic defining events of the twentieth century (Borradori, 2003). It has deep and far-reaching consequences in those regions where it most directly affected society, and may take generations to erase.

For analytical purposes, Lawrence Kohlberg's (Kohlberg and Turiel, 1971) theories of moral and ethical behavior were useful in identifying the stages of CSR attitudes in Latvia. Only one percent of the organizations included in the sample viewed CSR as an obvious, self-evident concept. Partial CSR programs were reported by 45 percent of respondents, while only 10 percent had adopted CSR programs completely. As noted earlier, only a few businesses have elected to formally adopt the UN's CRS Global Compact.

Most of the 987 respondents did not indicate that any social responsibility priorities played a role in their strategic operations. Most respondents did not know anything about CSR, could not understand its rationale and goals, or define the term social responsibility. A general goal reported by some respondents was the Utopian notion of a decent life for everyone in a fair and just society. Such expressions have not normally been associated with similar CSR studies. Operationally, this meant "doing things right." There was general agreement on the nature of business; it was also clear that the actual practice of operating a business could be shaped by external economic conditions and the assistance of the personal ethics and sense of responsibility of the top managers.

Attitudes Toward Change

In early 2008, a time of relative affluence, the attitudes of entrepreneurs toward change and toward great social responsibility were, at best, mildly favorable. The study identified three categories of decision-makers; each of these groups responded with a different concept for CSR. The first included entrepreneurs who feel that their only responsibility to society was to serve their own personal interests. Their compliance with conflicting public controls was best described as the avoidance of penalties. They found no ethical difficulty in shifting private costs to the public sphere. Their leadership style was autocratic, and was characterized by a direct search for personal benefits; they really had no use for CSR.

The second level included business owners and managers who, in addition to common business activities, respected social norms. They readily observed the laws and the controlling regulations affecting their operations. When necessary, they explained their situation to the public. They negotiated with government agencies, mostly through industry groups. They saw themselves and their firms as responsible and respectable corporate citizens.

At the third level of CSR involvement, senior managers were heavily influenced by the values governing company operations. Their critical attitude was inclined toward gradual, if not reluctant, change. They desired the strict enforcement of laws and regulations, as well as public discussion of desirable actions to be taken. They did not necessarily trust nor quickly approve all proposals for social improvement. Rather, they examined the proposals analytically and with due caution.

This group included managers and others who were influenced by a commitment to do things right; they believed in acting in accordance with their ethical norms and values of fairness and justice. These respondents were the principal supporters of substantial CSR; they were ready to pay higher prices and to tolerate their higher costs by shifting some profits to benefit the public. They were also careful to balance their own interests with those of the public by supporting a range of socially responsible programs, including the preservation of the environment. Finally, they favored establishing a business code of ethics and industry behavior norms.

Emerging CSR Programs

CSR approaches had been adopted by ten out of fifty leading organizations in Latvia (20 percent). The programs ranged from specific, isolated public relations programs to complete CSR programs. Between them, a common approach was to tie limited CSR programs to business goals.

A more comprehensive approach was claimed by companies that were most sensitive to public opinion. These companies included distillers and breweries, banks, forestry, and such public service companies as the postal service. The management of these organizations tended to realize that CSR is changing from a purely voluntary activity to a normal, perhaps mandatory, management function. The management tasks in those enterprises required close coordination of a wide range of management options. There were more frequent contacts not only with government agencies, but also with what Latvians called the "social partners" of the enterprise: labor unions and industry groups, as well professional associations.

One example of a successful balanced approach to CSR was the program implemented by a brewery and soft drink company. The management committed the firm to being a publicly responsible spirited company, devoted to supporting reasonable consumption patterns in Latvian society. Another example was the approach taken by a pharmaceutical firm. Their program reflected the private interests of the company as well as direct and indirect investments in public benefits associated with scientific research, medicine and health services, education and culture.

Obviously, private and public institutions that adopt CSR are guided by many different social priorities. Given these various private and public priorities, limited means, as well as problems where solutions could not be reconciled with each other, CSR takes many forms, all of which may demonstrate the good citizenship of the corporation involved. In practice, however, the implementation of CSR was of necessity focused on public relations; acting responsibly is considered to be more important if the public is aware of the actions and the company is given credit where credit is due.

Reasons for Adopting CSR

Three main reasons for adopting CSR were given by the firms in the sample. The first was as a reaction to the dictates of the personal values of the company's owners and corporate managers. The second was to improve the extent to which the firm's marketing objectives and policies aligned with CSR. The third was related to expected business success, including enhanced reputation and increased competitiveness and the generation of trust in the organization among its clients, suppliers, and investors. More importantly, business respondents indicated that CSR, or the lack of it, was a business decision, and not based on personal considerations. For most of the sample, however, social programs were generally considered to be a responsibility of the government, not businesses.

In summary, the research findings indicated that CSR in Latvia was still at an early stage of development. Although 45 percent of survey respondents reported some CSR activity, only 10 percent could claim programs of substance. Important areas of potential high cost to the company, such as improvements in work safety, were mentioned by less than 1 percent of the respondents. Overall, Latvian firms were characterized by:

- A lack of understanding of the nature and applicability of CSR.
- Confusion and contradictory ethical values and attitudes about social responsibility.
- Excessive and exclusive preoccupation with internal costs and little concern for external damage.
- Inadequate attention to local and international interdependencies.
- Confusion about the wide range of concepts to guide CSR, including the traditional expectation to run a company effectively and remain profitable in the marketplace. In contrast, there were also expectations for more egalitarian standards of general welfare, and the notion that it was the responsibility of business to provide this.
- A substantial diversity of CSR actions taken.
- The perception that CSR was adequate as long as the company's actions were profitable and legal.
- Underdeveloped cooperation between private corporations, non-government organizations, and local and transnational government agencies to achieve a better balance in increasing both private and social benefits. There was a strong desire for uniform regulations to reduce competitive disadvantages for companies oriented to CSR.
- A lack of long-range plans and educational programs, CSR is, to a large degree, an effort in improving public relations.

More importantly, positive CSR activity was identified with helping to reach business goals by 17 percent of the survey respondents, improving employee welfare was the reason given by 13 percent, resolving social problems and supporting external environment by 10 percent each, with other reasons scattered among lesser priorities.

One possible unrecognized benefit to follow from the public discussion of CSR is the clarification of goals for many of the companies. For example, 62 percent of the sample indicated that the principal CSR goal to emerge was the improvement to sustainable competitive advantage. The advancement of education and culture and the preservation of the physical environment were also mentioned as potential strategic goals.

Conclusions

While tracking CSR trends at a time of a deep economic, political and social crisis in Estonia, Latvia and Lithuania in 2009 was difficult and disappointing, the findings of this study corroborated similar results found in earlier studies of attitudes and opinions in the Baltic States by King and McNabb. As Latvia's fiscal austerity became more critical than Iceland's, other economic hardships ensued. One was a scaling back of interest in adopting CSR as a "triple bottom line" component. Managerial decisions were instead focused on the preservation of the enterprise, if necessary, at the cost of curtailing expenditures on social responsibility. Public discussions of business and economic issues often reverted to negative judgments about business and political institutions reported in earlier surveys of values.

After some measurable decline, distrust in the government advanced to an extremely high level. According to the respected DnB Nord Latvian Barometer surveys (*Barometrs* 15, July 2009), four fifths of the population surveyed felt that the government's economic programs were headed in the wrong direction, and nine tenths found the situation "very bad." The public suggested a broad range of actions as being necessary, ranging from discharging all corrupt office holders, reducing bureaucratic paperwork, eliminating duplicate functions, reducing administrative structures, raising the competence levels of government workers, and an overall reduction in the numbers of government workers and government patronage.

Possibly our most important conclusion is the unqualified corroboration of the hypothesis that there was no substitute for mutual trust in society. While trust levels have increased somewhat among students in institutions of higher learning, the 2008 date of the last survey makes it difficult to fully accept the conclusion that a strong positive trend in citizens' trust is underway. We recommend more research in this area to determine the rate and direction of change over time.

As expected, it appears that prosperity and expectations of a better future were helpful in shoring up public trust and faith in the economic, political and social institutions of society. This is particularly relevant among highly educated workers in the initial or early stages of their careers. With convictions more appropriate for a modern economically advance society, expanded knowledge and new skills, the young may be better prepared to work through recessions than the managers of earlier generations. The actions of older managers and administrators are likely to reflect the values and attitudes of their earlier schooling and experience, and be less willing to bet on future benefits from company expenditure on public welfare. They lack trust in the new competitive, global business environment, and tend to rely more on patronage and other friendly relationships for their imagined or real success.

Business managers' belief in the value of corporate social responsibility was re-examined in 2009. Conflicts between the government and the less advantaged elements of the population put on hold much of the progress observed earlier. Acceptance of CSR, often associated with international and larger domestic firms, had declined. Throughout the Baltics, managers and government administrators were unable to adjust to the deep economic crisis. They tended to revert to previous, socially less responsible practices.

These difficulties did not reduce the need for further adoption of CSR. If anything, steep government budget cuts increased public stress and immobilized the necessary changes. Increased international and local interdependencies, technological improvements, and dramatic demographic changes expanded the practical applicability of CSR concepts. Like all the other demands upon government and business, they called for the injection of new social and financial capital.

In practice, CSR may need to become more broadly based and professional. As more and more local and international institutions such as the EU, UN and OECD issue rules and standards, planning and implementing CSR programs has become increasingly complex. There is a great danger of the idea being smothered under a sea of paperwork. Sophisticated CSR programs required mutual trust and the close cooperation of company management, government administrators and regulators, and a host of external stakeholders. Professional CSR standards require, above all, that both business and government do no harm to the public.

Future progress in the adoption of CSR principles and practices throughout the Baltic States are expected to be difficult at best, and particularly difficult in Latvia and Estonia. Incorporating CSR costs and benefits into careful strategic planning will be increasingly necessary if greater progress is to occur (Smith, 2002). Daniel Yankelovich expects such progress to come slowly and unevenly. The public's views tend to take at least ten years to transform from a raw opinion, delusions and wishful thinking to emotionally responsible judgment (Yankelovich and Ratan, 1992). The aging population in each of the Baltic States, along with very slow or negative population growth throughout Europe, will bring forth the need for major social responsibility challenges that are not really anticipated today. They will require both government and business to shoulder the responsibility.

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Budgeting as a Means for Communicating CSR: the Case of the Tallinn City Government

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Abstract

This case study focuses on CSR communication via budgeting in the capital of Estonia during the last 75 years. Estonia has been ruled by Denmark, Germany, Sweden and Russia for lengthy periods of its history. The first period of Estonian independence lasted for 22 years, beginning in 1918. In 1940, the Republic of Estonia was occupied by the Soviet Union. Estonia regained its independence in 1991. The authors of the present article analysed and compared the annual budget books of the city government in each of these three periods from the viewpoint of the concept of Corporate Social Responsibility, transparency and accountability. As a result of the study an original model for measuring changes in CSR orientation was designed.

Keywords: accountability, budgeting, Corporate Social Responsibility (CSR), public sector, social capital, sustainability, transparency

Introduction

Today, *transparency* is a very frequently used term, which cannot be found in accounting dictionaries; however, in the literature related to Corporate Social Responsibility, corporate governance, public sector accounting and accountability, this term is one of the key terms and issues. Doubtless, transparency means different things to different users. Usually, transparency implies openness, communication and accountability. It can be defined as “the essential condition for a free and open exchange whereby the rules and reasons behind regulatory measures are fair and clear to all participants” (Business Dictionary, s.a.). For example, President Obama issuing new orders designed to improve the federal government’s openness and transparency said: “A democracy requires accountability, and accountability requires transparency” (The Washington Post, 2009). His memo states that the Obama Administration “will work together to ensure the public trust and establish a system of transparency, public participation and collaboration. Openness will strengthen our democracy and promote efficiency and effectiveness in government” (Ibid).

Corporate Social Responsibility (CSR) promotes a vision of business accountability to a wide range of stakeholders. Key areas of concern are environmental protection and the well-being of employees, the community and civil society in general, both now and in the future. Thus, CSR is about how companies conduct their business in an ethical way. The stakeholder approach was introduced by Freeman (1984), who emphasized the idea of ethical balance between the interests of the firm and the stakeholders in a perspective of strategic management.

The CSR concept started to attract increased attention with the work of Bowen (1953), who

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focused on the obligations of business toward the expectations of the very society that permitted its existence and conferred on it legitimacy.

In the current exceptional circumstances, Corporate Social Responsibility is even more crucial than ever, said European Commission President José Manuel Barroso speaking at CSR Europe's General Assembly in Brussels on 11 June 2009 (Website of CSR Europe, 2009). Barroso said: "The crisis resulted, in part at least, from a failure by some businesses to understand their broader ethical responsibilities. Now all businesses must rise to the challenge." *(Ibid).*

How about accountability in the public sector? Even Weber represented bureaucracy as a threat to parliamentary democracy (Kolthoff *et al.,* 2006). Once bureaucracy is established, he said, it becomes almost impossible to abolish. Moreover, it serves as a "power instrument of the first order – for the one who controls the bureaucratic apparatus" (Ibid). Kolthoff *et al.* have found that sometimes the words *value, integrity* and *ethics* are non-existent in the capacious books directed towards the New Public Service, and they stress that we need to rethink what we mean by democratic accountability – today we only have accountability for *how* government does what it does but we should also care about *what* government does (Ibid). Wolf, who published a well-known Russian accounting journal in 1888–1904, already says that it is not significant how to account; the most critical things are what we account for and why (Järve, 2009).

Davis (2009) claims that the degree to which various stakeholders in different countries wish to be transparent is culture-bound. For example, Scandinavian countries have a comparatively high degree of transparency in the public sector *(Ibid).*

Unfortunately, accounting information has become more aggregated and non-transparent (Bushman and Smith, 2003; Näsi, 2008). According to Benito and Bastilda (2009), budgetary information is the government's most important financial information, whereby policy objectives are reconciled and implemented in concrete terms. Nonetheless, politicians have little incentive to issue simple, clear and transparent budgets because the more information the budgets disclose, the less politicians can use fiscal deficits to achieve opportunistic goals (Ibid). In this context, the Organization for Economic Co-operation and Development (OECD) has highlighted the need for budget transparency in order to achieve better governance in public sector agencies (OECD, 2001). When transparency is achieved in budget reports, decision-making is improved and citizens have more incentive to vote (Benito and Bastilda, 2007).

This paper examines accountability in the local government of Estonia. Our analysis is based on numerous annual budget books from the Tallinn City Government for 1934–2008 including all three periods of the Estonian state: the period of the first independence, the occupation period and the re-independence period.

Theoretical Background

According to Gray *et al*. (1996) and Cornwall *et al.* (2000), accountability involves two different (but linked) responsibilities:

1. the duty to undertake certain action,
2. the duty to provide an account for those actions.

Najam (1996), speaking about non-profit organizations, identifies three categories of accountability concerns:

1. accountability to patrons,
2. accountability to clients,
3. accountability to themselves.

Corporate social responsibility is about the company's accountability to all of its stakeholders. For example, Tanimoto and Suzuki (2005) define CSR as a concept whereby companies fulfil accountability to their stakeholders by integrating social and environmental concerns in their business operations.

The concept of CSR does not have a generally understood meaning. In the European Union CSR is a part of the official policy as a factor improving competitiveness and the EU definition of CSR is: "A concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". Although the concept of CSR dates from the fifties of the last century (Norris and Innes, 2005:10) and theoretical perspectives on CSR have been developed for over two decades (Carroll, 1979; Freeman, 1984; Donaldson and Preston, 1995; Clarkson, 1995; McWilliams and Siegel, 2001), its practical implementation has increased in importance only in the last decade (Kawamura, 2004; Balmer *et al.,* 2007).

CSR benefits businesses economic performance, their reputation and employee relations, improves their compliance with legislation and enhances their risk management (Freeman, 1984; Matten and Moon, 2004).

The concept of CSR is underpinned by the idea that corporations can no longer act as isolated economic entities operating in detachment from broader society. Traditional views about competitiveness, survival and profitability are being swept away. Organisations begin to recognize that their role goes beyond a purely economic one, and that it has certain other duties and obligations (Reidenbach and Robins; 1991). Juščius and Snieška (2008) claim that only companies that aim to save all universally accepted ethical standards of social behaviour, can expect a positive attitude and support in modern society. Nowadays, corporate social responsibility is an integral part of the business vocabulary and is regarded as a crucially important issue in management (Cornelius *et al.,* 2008; Humphreys and Brown, 2008).

The attention to the relationship between CSR and social capital is a recent development, but it is starting to assume a significant relevance (Andreaus *et al.,* 2009). The reason for that is that CSR can be understood as the business contribution to sustainable development, and according to Coleman (1988), social capital is definitely one of the pillars of a sustainable society (Ibid). Putnam (1993) sees the forms of social capital as the general moral resources of the community, which can be divided into three main components: first, trust (and more generally positive values with respect to development); second, social norms and obligations; and third, social networks of citizens' activity, especially voluntary associations.

Coleman (1988) claims that the forms of social capital are self-reinforcing and cumulative by nature: the more social capital is used, the more it grows. Additionally, Bourdieu (1986) asserts that a bureaucratic organization is an effective administrative tool in concentrating social capital and transforming quantity (the number of members) to quality (organizational effectiveness).

In the last ten years, multiple studies have become available that analyse the relationship between CSR and culture. Some authors (Hillman and Keim, 2001; Wieland, 2005; Rooney, 2007; Thornton and Jaeger, 2008) have found that there has to be congruence between organizational culture and CSR, and they claim that in general CSR should be seen as an embodiment of the organization's culture and values. Many empirical studies have confirmed that individual and organizational values are significant predictors of CSR managerial behaviour (Branzei *et al.,* 2004; Vitell and Paolillo, 2004; Hemingway, 2005; Waldman *et al.,* 2006).

Developing a CSR orientation is possible only if a supportive organizational culture emerges within the organization (Lyon, 2004). This statement highlights that an organization must achieve a deep comprehension of the ethical and cultural developments associated with CSR if it wants to reach a genuine CSR orientation (De Woot, 2005). Developing CSR initiatives thus often demands the cultural evolution of the organization. Moreover, organizational cultures can represent information, knowledge and know-how that may support or spoil CSR efforts (Doppelt, 2003).

Some researchers have analysed the impacts of national culture on CSR. Waldman *et al* (2006) have shown that while institutional collectivism predicts the values of CSR in a positive direction, in-group collectivism has no significant effect on CSR. Additionally, Ringov and Zollo (2007) have found that cultural differences with respect to individualism had no significant effect on CSR. Chen *et al* (2001) claim that individuals with communal orientation demonstrate greater socially acceptable views and norms, which means that they link power with responsibility goals. Ringov and Zollo (2007) and also Scholtens and Dam (2007) have concluded that masculinity has a significant negative effect on corporate social performance and ethical policies. Husted (1999) has proven that managers in countries with high power distance, masculinity and uncertainty can easily engage in corrupt business behaviour.

Accountability and transparency are two major principles of public sector governance to ensure that stakeholders are able to make informed judgements about the performance of the government (Lee, 2008). One of the most important dimensions of accountability is financial accountability, which is fulfilled through the provision of financial information so that citizens can see how their taxes are being spent (Pina *et al.,* 2007). But government activities should not be evaluated only from the financial perspective because they are non-profit entities driven by the objective of providing public services (Lee, 2008).

Pignatel (2010) notes that corporate social responsibility covers a much broader issue including human rights, health and safety, employee welfare, environmental protection, and ethics rather than a sole economic focus. Therefore, corporate social and environmental reporting can serve as a useful medium to channel information to social actors (Ibid). Moreover, Kolk (2008) argues that the increasing pressures on companies with regard to accountability following the financial crisis have placed transparency and accountability in distinct focus, and he concludes that more firms are offering wider information with regard to sustainability issues targeting broader audiences to increase transparency and accountability.

Background of the Study

Kolthoff *et al* (2006) stress: “Do not assume that the public sector is more ethically aware than the private sector. In other words: developments in the business sector can contribute toward making the public sector more ethical.”

According to Kooskora (2008), the modern business environment in Estonia is relatively young and companies are still coming to understand new methods and new paradigms such as CSR. The Estonian CSR Index 2009 indicated that reporting on CSR is weak even among companies that already practice CSR. The average index score for companies was 60%, while the score obtained by Tallinn City Government was 58% (Roostalu, 2009).

According to Hofstede (The Website of Hofstede’s works, s.a.) there are considerable differences between Estonian and Russian national cultures (see Figure 1).

In Russia, the highest cultural dimension is avoiding uncertainty, indicating the society’s low level of tolerance for uncertainty. In making an effort to minimize or reduce this level of uncertainty, strict rules, laws, policies and regulations are adopted and implemented. There is also a very high power distance that is indicative of a high level of

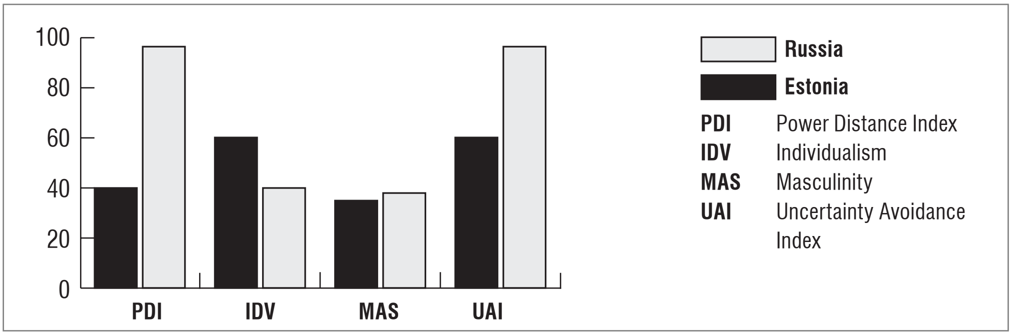

Figure 1: Comparison of Estonian and Russian national cultures

inequality of power and wealth within society *(Ibid)*.

Estonia freed itself from a foreign power almost 50 years after being annexed. Lagerspetz (1996) has found that even though the Soviet doctrine had never reached the position of ideological hegemony in Estonia, the legacy of the regime is often still visible in Estonian public organizations — mostly in people's behaviours and mindsets.

Since public administrators' values and attitudes directly affect the processes and outcomes of public administration — often more than the structures and processes themselves — Estonian local administration is still rather far from "good public administration" (Drechsler, 2004).

Tõnnisson (2006) believes that the Estonian public sector lacks a clearly established system of values, and thus, the formation, propagation and reinforcement of such values should be initiated.

According to Vinkel (2008), the prevailing organizational culture in Estonian municipalities is a clan-like culture, where family-like affairs, good relations between workers and the lack of competitiveness are valued, while in other countries the prevailing organizational culture for institutions in the public sector has traditionally been a hierarchical one. Übius and Alas (2009), according to their study in 8 countries, have proven that three organizational types – clan, hierarchy and adhocracy –– predict two facets of CSR (i.e. the organization's performance concerning social issues and the organization respects the interest of agents), and the fourth type of organizational culture, market culture, predicts one facet of CSR (i.e. the organization's performance concerning social issues).

The Legatum Prosperity Index 2009 shows that Estonia holds the 31st place among 104 respondents, but Estonia's results in social capital, which is a part of the index, are very bad – Estonia holds the 94th place (Legatum Prosperity Index, 2009).

Purpose and Methodology of the Study

Our purpose was to find out how the budget books of the city government portray the city's ethical behaviour and CSR orientation, and whether there have been better times for social capital in Estonia. There are no data on such studies in Estonia – some authors have studied the use of management accounting information, both in the private and public sector, but not from the viewpoint of CSR. Moreover, the authors of the present article have no information about any studies anywhere in the world focusing on CSR communication via budgeting, although there are several studies devoted to various types of responsibility reporting.

The content analysis as a qualitative study method was used for analysing the body of annual budget books. Using quantitative content analysis in CSR researches is not new. We could not use quantitative methods of content analysis for counting some phrases or words because these budget books did not include any primary phenomena of CSR – they were rather hidden in the background of the content and we needed to read between the lines. Thus, first a Critical Discourse Analysis (CDA) was used. Fairclough's (1989; 1995) model for CDA consists of three inter-related processes of analysis tied to three inter-related dimensions of discourse. These three dimensions are:

1. The object of analysis (including verbal, visual or verbal and visual texts),
2. The processes by means of which the object is produced and received (writing/speaking/designing and reading/listening/viewing) by human subjects,
3. The socio-historical conditions which govern these processes.

According to Fairclough, each of these dimensions requires a different kind of analysis:

1. text analysis (description),
2. processing analysis (interpretation),
3. social analysis (explanation).

Next we applied a content model to the results of the CDA, which we designed based on the example of Portes' model of social capital, where both positive and negative categories or outputs of social capital are taken into account (Portes, 1998; Portes and Landolt, 1996). In our model some categories of CSR are similar to outputs of the Portes model. Additionally, according to the results of the CDA we added several new categories and grouped them all with the various phenomena of CSR, and finally, we grouped these phenomena with the three main groups describing the three dimensions of CSR (see Appendix). These three dimensions form our three-part model. As the number of the analysed budget books for each period was not equal (there were 6 books for the 1st period and 9 for the other two periods) we could not use absolute values for the results of the content analysis. Thus, we used a homogenized scale with rates of densities where "-1" was the largest negative value used by the negative categories and "+1" was the largest positive value used by the positive categories. These values can be classified as the performances of the categories. For example, if a positive category existed only in three budget books out of the total 9, we calculated its performance as 3/9=0.33 (or –0.33 if it was a negative category).

Empirical Data and Analysis

In this section we present the results of our model and some of the best examples of the city's activities during the three periods under investigation related to the model.

The 1st Part of the Model – the Economic Dimension of CSR

Here we selected and assessed three phenomena of the economic dimension of CSR: balanced budgets as a keyword for economic stability, the transparency of budgets and the technical level of budgets. The latter two include many categories (see Appendix). An aggregated overview of the results of this dimension is given in Figure 2. The figure shows that the city government had the highest transparency of budgets in the 1930s. In the Soviet period, transparency decreased while the technical level increased. Today, these two factors are slowly increasing.

Example 1

The city's budget books from the 1930s include several long tables in the appendices that take 2-3 times more space than the budget itself and offer a lot of useful information on the priorities and operation modes of the local government related to the com-

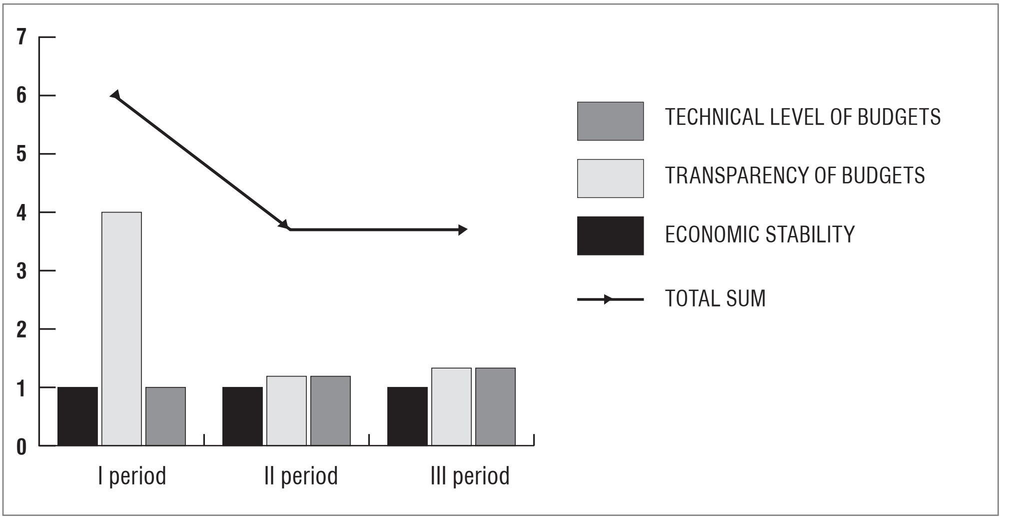

Figure 2: Changes in the Economic Dimension of CSR

munity and other stakeholders. The largest table (49 pages!) describes the labour costs of all officials and other workers providing their first names, surnames, positions, monthly wages, wage groups (or levels), tenure, rent for accommodation and other costs where applicable (Tallinn, 1934: 195-243).

Example 2

Immediately after the Soviet occupation, the *nomenclature* in the new local government took for granted that they deserve better wages. In the first budget book in this period, 24 pages are filled with argumentations for each post (names were no longer specified) that the wages must be increased "because there was an increase in work load" or – where wages were much higher – "because there was an increase in work load and responsibility" (Tallinn, 1940: 11-34).

Example 3

In the introduction to the first budget book after re-independence, the financial department has written that "this book is addressed to all interested people in- and outside the city organization because in the conditions of a democracy a greater openness is needed, while during the Soviet period only 20 pages were covered with explanations of occupational work"[1] (Tallinn, 1993: 3).

The 2nd Part of the Model – the Environmental Dimension of CSR

The phenomena that belong to this group include environmental protection and control over the consumption of natural resources, where the uses of both natural and financial indicators were assessed (see Appendix).

We can conclude that in the 1930s, managing this issue was a little bit better, while in the Soviet period, it was significantly weaker (see Figure 3).

Example 4

In the 1930s, the dog tax was 15 crowns per year, but for blind and deaf-and-dumb people it was only 1 crown. Members of sports clubs were exempt from the tax on water vehicles "as long as these vehicles were not used for increasing incomes"[2] (Tallinn, 1936: 28).

[1] In the 1950s, instead of budget books and budget project books we can only see brochures including financial numbers without explanations. These brochures are both in Estonian and in Russian while before only Estonian language was necessary
[2] In 2009, the Tallinn City Government also validated the boat tax, but without any exception.

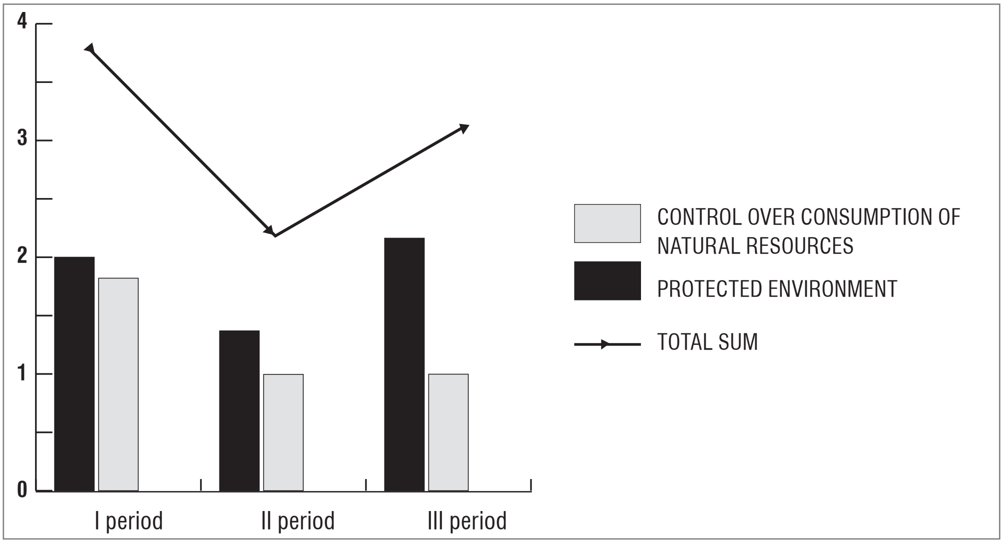

Figure 3: Changes in the environmental dimension of CSR

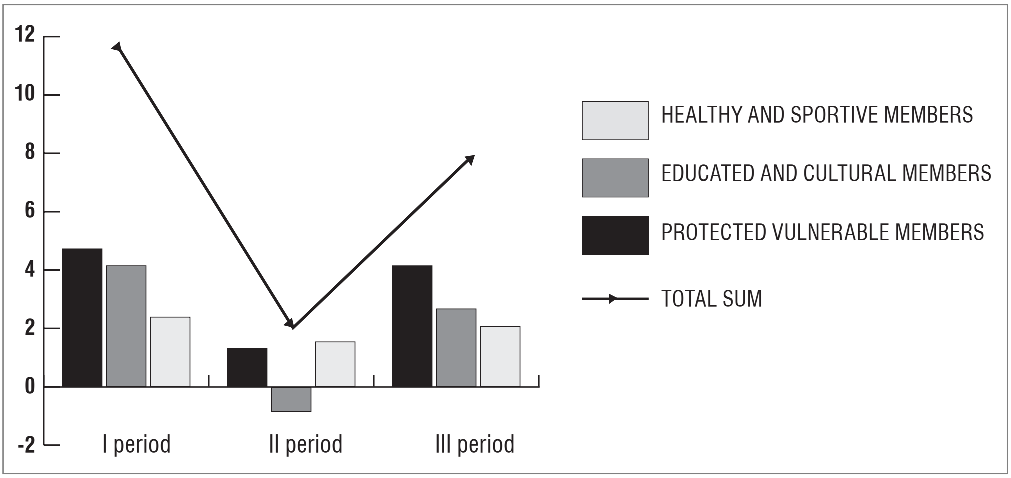

Figure 4: Changes in the Social Dimension of CSR

The 3rd Part of the Model – the Social Dimension of CSR

In this dimension we had 20 categories (see Appendix), which were grouped according to the three phenomena (see Figure 4). As the other parts of our model include 18 categories altogether, the opportunities to score here were greater, too.

Unfortunately, in the Soviet period the city government's score for social tasks was much lower than that of the other two issues. Moreover, in the field of education and culture the results were negative. Thus, in the second period, a rapid fall occurred.

Example 5

In 1937, when the city government had planned to increase the wages of all workers via tenured wages, it was decided that low-paid work-

[3] Unfortunately, this nice tradition has not been followed anymore, and in fact, using equal coefficients, which is quite common, increases the differences between high- and low-paid workers' wages.

ers need a greater rise in wages (6.5 % – 32.5% of the basic wage) than high-paid workers (4% – 20%)[3] (Tallinn, 1937:78).

Example 6

In the 1930s, retired or workers with a lengthy service as well as officials with families received one-off or permanent benefits. All the beneficiaries including their names, positions, tenure, benefit sums and remarks about the real beneficiary (to himself, his widow, etc.) were listed in the appendix. In 1934, the list of beneficiaries included 129 people and most of them were ordinary people such as builders, stokers and street-cleaners (Tallinn, 1934: 264-266).

Example 7

In 1945–1970, taxes from the community included the following (Tallinn, 1950:12): income tax and "the tax on citizens of the Soviet Union who are unmarried, single or having few children ". According to an appendix in the budget book, 25% of taxpayers had no children, 42% had one child and 33% had two children[4] (Tallinn, 1950, 286).

Example 8

In the 1950s, the rates of VAT (actually a tax on turnover, not value added tax) were very different and most were unbelievably high. These rates or rate ranges were probably validated in Moscow, but we are sure that the city government also had some freedom to validate them because, for example, the leather shoes manufactured in two different factories had different rates of VAT: at Kommunaar, which produced higher quality goods and was not openly accessible (i.e. reserved for white-collar workers in high positions), it was only 13%, while at Artell, which made common shoes, VAT was 20% (Tallinn, 1950: 196-206). Moreover, in Pohjala, where rubber boots were made for ordinary people, the taxes were 69.5% on men's boots, 72.3% on women's boots and 74.4% on children's boots (Tallinn, 1950: 196-197). Additionally, other basic commodities such as food were also highly taxed: cereals at 90%, meat at 80%, sugar at 78% and milk at 57% (Tallinn, 1950: 177-190), while nonessentials were not: for example, stationery was taxed at 24% (Tallinn, 1950: 224). It is important to point out the alcohol policy at this time that vodka had the highest tax rate – 1000% (Tallinn 1950: 178).

Example 9

According to the budget of the Estonian Soviet Socialist Republic (ESSR) from 1945, all kindergartens and most orphanages were funded by local governments and food costs per child in orphanages were 1.5 times higher than in kindergartens (Eesti NSV, 1945: 32-33). The food calculations of the city government show that five years later this difference was 1.3–1.4 (Tallinn, 1950: 94-96). Additionally, there were large differences in the norms of milk, butter and fresh fruit. In orphanages, fruit was totally lacking, while in kindergartens the fruit norm was 100 grams and in two special kindergartens for children with weak health conditions it was 200 grams. The norms for butter were 17 grams in orphanages, 30 grams in kindergartens and 50 grams in special kindergartens. The norms for milk were 250 grams in orphanages, 300–350 grams in kindergartens and 500 grams in special kindergartens. In orphanages, the norms for potatoes, vegetables, fish, cookies and candies were slightly higher *(Ibid)*.

Example 10

In 1992, the city government and all the city's district governments established reserve funds where in 1993, many payments were made to theatres, choirs, sports associations for the handicapped and other associations for handicapped people, children's associations, sport clubs etc (Tallinn, 1993: 53-56).

[4] In the 1970s Soviet statutory law became slighty milder: all married women and all men even very young and single who did not have any children had to pay this childless tax.

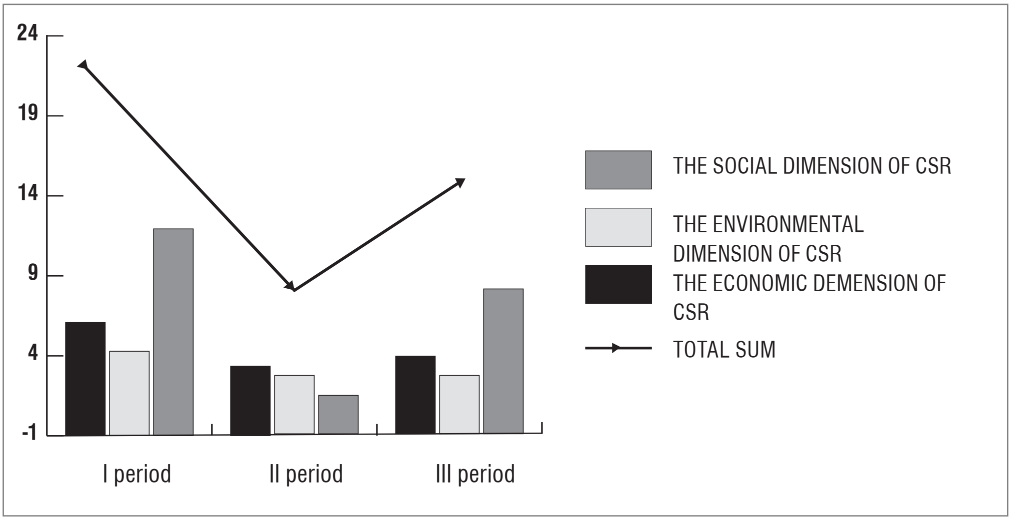

Figure 5: gives an aggregated overview of the results.

The Final Results of the Model

Hence, although there were no differences in financing social and environmental tasks during the three periods – the rates of funds for these tasks were consistently between 88% and 90% of the budget sums (Tallinn, 1934-1940, 1949, 1950, 1959, 1969, 1979, 1989, 1990, 1991, 1993, 1995, 1998, 2001, 2003-2005, 2008) – we can see big changes in CSR orientation.

As CSR is related to social capital, we can suppose that there was also a decrease in social capital.

Conclusions

Habermas (1981) defines communicative action as a form of social interaction in which the plans of action of different actors are co-ordinated through an exchange of communicative acts, that is, through the use of a language orientated towards reaching an understanding. This paper observes the communication of corporate social responsibility via the budget books of the capital of Estonia during the last 75 years, including all three periods of the Estonian state: the first period of independence, the occupation period and the re-independence period.

Our approach is based on content analysis of annual budget books of the city of Tallinn. As a result of the study, a model for measuring changes in CSR orientation was designed. As we have no data about papers presenting such a model, we are sure that we can assume originality in our modelling.

The results of the study show that regardless of equal financing tasks in all three periods, there were large differences in the essence and aims of the social and environmental tasks of the local government.

The study indicated that in the 1930s, the city government had the highest ethical behaviour and CSR orientation, which means that in the Estonian public sector some CSR principles were used 15–20 years before Bowen's famous work. The authors found that in the 1930s, the budgets were very detailed and transparent. Moreover, the budget policy of the city government was directed towards the well-being and support of the community as a whole, especially its most vulnerable members. There are also several examples about voluntary activities in the city.

Developing a CSR orientation and business ethics was interrupted by the occupation; although, the level of general accounting tools increased. It can be said that the local government executed its tasks within the framework of the law.

Finally, it is argued that since the Republic of Estonia regained its independence, Tallinn City Government has been rehabilitating its ethical face.

We found that the accountability of the local government of Estonia was suppressed by the Soviet occupation, but nowadays it is increasing again. Accountability is related to the process of lawmaking and legitimacy (Stahn, 2004). Coming back to Habermas, we stress that for him legitimacy is first of all creditworthiness (*Anerkennungswürdigkeit*) (Habermas 1976: 271). Habermas defines his famous discourse as a procedure where all actors having equal rights and using communicative actions reach a consensus on the truth, which becomes the only legitimate one (Habermas 1992: 138). Thus, Habermas claims that only those norms of behaviour are legitimate, which are accepted by all actors in the discourse. Moreover Habermas' discourse can be interpreted as the only means for democratic law-making (Käärik, 2009; 1998; Dy, 1994); although, many authors have criticised this viewpoint *(Ibid).* Here we agree with Dy, who claims that Habermas' ethics of discourse provides us with a foundation or standard for discussing and judging what is right or wrong in the context of society (Dy, 1994).

Additionally, Van Liempd (2010) worked out three normative models of accountability reporting using a Habermasian framework – the free-market libertarian, the democratic republican and the deliberative discursive model *(Ibid).* The first of these models can be characterized as the shareholder model, the second as the stakeholder model and the third as the societal model, where the relationship between business and society is embedded with ethical and moral values, and responsibility is an ethical obligation. Van Liempd concludes *(Ibid)*: "As a result, accountability becomes an enabling technology that creates an interchange between all levels in the society with a view to representing the interests of all citizens, not just the selected or privileged few. It looks at the common good, in a fair and just way, and not just at the individual good. Through a deliberative discourse in the public sphere, citizens have to decide on a maxim, which can be generalized out of the perspective of all parts involved."

Ferlie *et al* (1996: 195-223) found that the lack of robust models of accountability in the public services now gives rise for considerable concern, and that this may represent the Achilles' heel of the new public management movement. Hughes (1996:68) noticed that greater transparency and freer availability of information will provide sufficient incentive devices for the maintenance of high ethical behaviour by government managers. Here we can argue that the present study provides additional evidence with respect to these standpoints from Van Liempd, Hughes and Ferlie *et al.*

Our investigation was designed to determine the effect of CSR orientation on the management information of local governments. This research has explained the central importance of transparency in budgeting to increase the levels of accountability and democracy. Taken together, these findings suggest an actual and ever-growing role for new public management in promoting CSR within the community and other stakeholders.

There are also limitations in this study connected with the methodology used. Namely, as our selection of categories and phenomena for this model was by nature a subjective process, we do not pretend to present an absolute truth from our results. It is not only our problem – content analysis always includes some subjective moments and there is no absolute truth for making such models.

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APPENDIX: CSR Content Analysis Model

FENOMENA OF CSR ORIENTATION	POSITIVE CATEGORIES	NEGATIVE CATEGORIES	I period	II period	III period
1. The economic dimension of CSR			6,0	3,4	3,7
Economic stability	Balanced budgets		1,0	1,0	1,0
Transparency of budgets	Detailed view of costs and revenues		1,0	0,3	0,4
	Detailed explanations of costs and revenues		1,0	0,3	0,3
	Budgets of each organizational entity		1,0	0,1	0,3
	Labour costs by each worker		1,0	0,1	0,2
	Bilingual budgets		0,0	0,7	0,0
		Dissembling	0,0	-0,3	0,0
Technical level of budgets	Product based budgeting		0,0	0,0	0,3
	Analytical accounting tables		1,0	0,6	0,4
	Cost accounting and cost prices of services		0,0	0,3	0,1
	Financial ratio analysis		0,0	0,3	0,1
	Accrual based accounting		0,0	0,0	0,3
2. The environmental dimension of CSR			3,8	2,4	3,3
Protected environment	Public parks and beaches		1,0	1,0	1,0
	Tallinn Botanic Garden		0,0	0,4	1,0
	Supporting environment protection organizations		0,0	0,0	0,3
	Boat tax		1,0	0,0	0,0
Control over consumption of natural resources	Measuring consumption of natural resources in financial indicators		1,0	1,0	1,0
	Measuring consumption of natural resources in non- financial indicators		0,8	0,0	0,0
3. The social dimension of CSR			11,5	1,7	7,8
Protected vulnerable members	Kindergartens, orphanages, hospitals		1,0	1,0	1,0
		Discrimination of orphans	0,0	-0,2	0,0
	Supporting child organizations		0,7	0,0	0,3
	Child benefits		0,0	0,0	0,6
		Tax on childless and other discriminatory taxes	0,0	-0,9	0,0
	disability allowances		1,0	1,0	1,0
	Supporting disabled people's organizations		0,8	0,0	0,6
	Supporting retired employees and their families		1,0	0,0	0,2
	Bonus for low-paid employees		0,5	0,0	0,0
Educated and cultural members	Supporting schools of ethnic minority		0,7	0,0	0,3
	Primary, secondary and vocational schools		1,0	1,0	1,0
	Supporting poor students in primary schools		1,0	0,0	0,0
	Scholarships in universities		0,7	0,0	0,4
		Study fees in secondary schools	0,0	-0,6	0,0
	Supporting culture and education organizations		0,7	0,0	0,4
		Taxes from public organizations	0,0	-0,9	0,0
Healthy and sportive members	Sport enterprises		0,5	0,8	1,0
	Supporting sport organizations		0,7	0,0	0,4
	Tax benefits for sportive and young people		0,7	0,0	0,4
	Alcohol policy		0,7	0,4	0,0
TOTAL SUM			21,3	7,6	14,8

The Causes of Reputational Crises in Chinese Organisations

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Abstract

The aims of this research paper are, first of all, to discover the causes of reputational crises in Chinese organisations, and then to define the connections between these causes and Chinese societal transformation. To complete this survey, exploratory, descriptive, and explanatory approaches have been implemented. The qualitative method (interview) has been selected to conduct data collection for this research since it enables one to gain greater knowledge and a deeper understanding of the detailed information. Starting in the year 2008, the author conducted crisis management research in China. In the following two years, 156 Chinese companies were interviewed. These companies are spread over fifty-seven Chinese cities and are active in various industries.

Based on the analysis of the interview results, reputational crises were found to be the second most frequently occurring crises among Chinese organisations. To seek the reasons causing reputational crises and discover their connections with Chinese societal transformation, a detailed analysis was carried out based on a study of all the reputational crises cases.

The results indicate that reputational crises are caused by various reasons which involve both the internal and external sides of an organisation. The author has discovered the connections between the reasons causing reputational crisis and contemporary China's transforming environment. This discovery will contribute to the crisis management theory. A series of implications constitute a practical reference for enterprise managers, especially Chinese enterprise managers when making a decision on an enterprise's development strategy and business direction. Expanding the study to a wider perspective and conducting more empirical research can help one to draw a more comprehensive conclusion.

Keywords: reputational crisis, ethical standards, value, Chinese societal transformation, social responsibility

Introduction

In recent years scholars (Dowling, 2002; Miller, 2003; Murray, 2004; Evans, 2007) have found that companies increasingly encounter reputational attacks. However, protecting their corporate reputation against these attacks has proved extremely difficult. Despite the challenges, organisations of all sizes and sectors need to be aware of the importance of reputation (Lees, 2003).

During the last quarter of the 20th century China started to reform its economic system and until today, China's economic and social structures have experienced major and sometimes extraordinary changes (Clegg, 2003). The rapid growth of the Chinese economy attracts more and more researchers to show interest in Chinese management. Some researchers have studied Chinese organizational change (Alas and Sun, 2007; Head,

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2005), some have studied a single case of corporate crisis in a Chinese organisation (Gupta and Wang, 2004). However, no study has dealt with the connections between reputational crises and Chinese societal transformation.

Therefore, this paper focuses on reputational crises in Chinese organisations. It aims to discover the causes of reputational crises in Chinese organisations, and then to define the connections between these causes and Chinese societal transformation. The research questions are as follows: (1) – What are the reasons causing reputational crises in Chinese organisations? (2) – Do these reasons stem from internal or external sides of the organisation? (3) – How did the Chinese contemporary social environment influence these causes? The author conducted this survey via interviews.

The study of crisis management in Chinese enterprises may help enterprise managers in China to avoid and handle crises efficiently. Furthermore, Chinese crisis management experience is used as a reference for other countries with a similar history and situation, for example, Estonia.

This paper is divided into three parts. Starting with the literature review, the theory of crisis and reputation management is introduced, after which the transformation in Chinese societal environment is presented. Subsequently, the hypotheses are proposed. Following is the empirical study, which includes the methodology, the sample, the results of interviews, the analyses, and the findings. Finally, the hypotheses are re-evaluated, and the conclusions and suggestions are presented.

Literature Review

Crisis

In the last several decades, many scholars have defined organizational crisis from various perspectives. Some researchers (Gephart, 1984; Perrow, 1984) assert that a crisis can be recurrent and non-preventable. Some scholars (Rosenthal *et al.,* 2001; Stern and Sundelius, 2002) consider crisis as an unwanted, unexpected, unprecedented, and almost unmanageable situation. Nevertheless, some other theorists (Meyers and Holusha, 1986; Roberts, 1989; Pearson and Mitroff, 1993) suggest finding ways to manage or avert organizational crises.

From an organizational perspective, Mitroff (2005) found that a crisis is an extreme event that literally threatens an organization's very existence. A crisis is a major occurrence with a potentially negative outcome affecting an organization, company, industry, as well as its publics, products, services, or good name (Fearn-Banks, 1996: 1). Here, the "good name" means organizational reputation.

Heath and Millar (2004: 2) defined crisis as an untimely but predictable event that has actual or potential consequences for stakeholders' interests as well as the reputation of the organization suffering from the crisis. A crisis may hurt or damage an organisation by "an event that brings, or had the potential for bringing, an organisation into disrepute and imperils its future profitability" (Lerbinger, 1997: 4).

From a social-political perspective, O'Connor (1987) suggested that a crisis is the realm of cultural symbols and lived ideologies. A crisis can be the threat of death or damage, but it also pertains to the invisible and intangible perils that are feared to destroy a community (Erikson, 1994).

Zyglidopoulos and Phillips (1999) defined reputational crisis as a situation in which important stakeholders negatively re-evaluate their opinions and beliefs about the firm. In this paper, the author considers reputational crisis in Chinese organisations as a situation that damages or may potentially damage an organisation's reputation seriously with insufficient time to know the causes or cope with it.

Reputation

Kay (1993) found reputation to be one of the three "distinctive capabilities"[1] of enterprises. Some other scholars, such as Deephouse (2000) and Fombrun (1998) argue that reputation is the most important competitive advantage that companies can have.

Dowling (2002) defined corporate reputation as the attributed values (such as authenticity, honesty, responsibility, and integrity) evoked from the person's corporate image. Jackson (2004) found corporate reputation to be a value-based composite that ranges from commerce to compliance to conscience. Reputation is the most important commercial mechanism for conveying information to customers and other stakeholders (Kay, 1993). Zyglidopoulos and Phillips (1999) pointed out that corporate reputation is a dynamic, stakeholder-based aspect of the corporate environment.

Researchers (Dowling, 2002; Moss and Warnaby, 2003; Lees, 2003) argue that reputations are not immutable nor are they created easily, and once established must be carefully preserved. Once lost, a corporate reputation is hard to rebuild (Murray, 2004). In other words, reputation is difficult to build up, but easy to destroy. So, reputation is a major risk issue for all organisations (Lees, 2003).

A good reputation can always be used to support the company's business (Dowling, 2002). A good reputation can: help the organization to optimize shareholder value (or an equivalent) by enabling it to attract customers and high quality employees; enhance the organisation in good times and protect it during the bad ones (Lees, 2003). According to Dowling (2004), a company with a good reputation has values that suit the individual's (evaluator's) own values.

However, there is no one right criterion for reputation (Siltaoja, 2006). Reputation is quite a dependent and critical term for organisations. According to Kay (1993), reputation is influenced by: people's experiences of a firm and its products; how the firm presents itself; and how employees, others and the media talk about it. Center and Jackson (2003) found that reputations are based on experience with a product, service, or company – or the expression of trusted comrades.

Many scholars (Carroll, 1979; Wood, 1991; Mahon, 2002; Brammer and Pavelin, 2004) have recognized corporate social responsibility as a matter that influences reputation. Furthermore, reputation can be examined from the SR aspect (Zyglidopoulos, 2001). Managers must first perceive ethics and social responsibility to be vital to organizational effectiveness before their behaviours become more ethical and reflect greater social responsibility (Singhapakdi *et al.,* 2001: 134). Besides, corporate reputation reflects an organisation's values (Dowling, 2004). According to Schwartz and Bardi's (2001) definition of values – they are desirable, trans-situational goals with varying importance, and they serve as guiding principles in people's lives. Thus, ethics and values are influential factors in the case of an enterprise's reputation.

The Causes of Reputational Crises

The process of crisis disruption is rooted in a combination of exogenous and endogenous factors (Comfort, 1988). Different crises follow different critical paths (Reason, 1990). A reputational crisis, therefore, has its own paths to follow. The reasons causing reputational crises vary. According to Zyglidopoulos and Phillips (1999), any number of negative events can cause a reputational crisis, such as accidents (Perrow, 1984; Buchholz *et al.,* 1985; Shrivastava, 1987), scandals (Sethi, 1977), and financial problems (Kent, 1993).

From the point of view of the criteria, Fombrun (1998) gives six reasons that may cause a reputational crisis in an enterprise: financial

[1]According to Kay (1993), the other two are "corporate architecture" and "innovation".

performance, product quality, employee treatment, community involvement, environmental performance and organizational issues. The community involvement and environmental performance are both exogenous and endogenous reasons. The other reasons are relate to the internal side of the enterprise.

Lees (2003) found that the causes of reputational crises originate from cultural, managerial and three main external sides. The cultural reasons could have both internal and external aspects, while the managerial reason stems from the internal side of the organization. Turner (1976: 381) stated that a disaster or a cultural collapse takes place because of some inaccuracy or inadequacy in the accepted norms and beliefs.

Sher (2006) comments on the reasons of a reputational crisis that it can occur when the corporation handles problems inappropriately in the areas of product and service, or when the corporation's behaviour harms the benefit of the consumer, which finally results in serious damage to the corporation's public image. Mitroff (2005) listed the reasons causing reputational crisis as follows: slander, gossip, sick jokes, rumours, damage to corporate reputation, tampering with corporate logos and false rumours.

Dowling (2002) listed four reasons for reputational crisis. They include the following: the enterprise's lack of perceived social responsibility; the manager's lapse of ethical standards while becoming greedy for huge short-term profits; deregulation of the markets and poor marketing. Marcus and Goodman (1991) identified three reasons as accidents, scandals, and product safety incidents. Table 1 summarizes the reasons caus-

Table 1: Reasons Causing Reputational Crises

<table>
<tr><th>Scholars</th><th>Internal</th><th>External</th></tr>
<tr><td>Perrow (1984); Buchholz et al. (1985); Shrivastava (1987); Marcus and Goodman (1991)</td><td>accidents</td><td></td></tr>
<tr><td>Sethi (1977); Marcus and Goodman (1991)</td><td>scandals</td><td></td></tr>
<tr><td>Marcus and Goodman (1991)</td><td>product safety incidents</td><td></td></tr>
<tr><td>Kent (1993)</td><td>financial problems</td><td></td></tr>
<tr><td rowspan="2">Fombrun (1998)</td><td>financial performance, product quality, employee treatment, and organizational issues</td><td></td></tr>
<tr><td colspan="2">community involvement, environmental performance</td></tr>
<tr><td>Zyglidopoulos and Phillips (1999)</td><td colspan="2">negative events</td></tr>
<tr><td>Dowling (2002)</td><td>lack of social responsibility; managers lapse of ethical standards;
poor marketing</td><td>market deregulation</td></tr>
<tr><td rowspan="2">Lees (2003)</td><td>managerial</td><td rowspan="2">external</td></tr>
<tr><td>cultural</td></tr>
<tr><td>Mitroff (2005)</td><td>tampering with corporate logos;</td><td>slander; gossip, sick jokes, rumours; false rumours</td></tr>
<tr><td>Sher (2006)</td><td>Inappropriate handling of problems in the product and service areas; corporation's behaviour harms the benefit of the consumer.</td><td></td></tr>
</table>

ing reputational crises presented by different scholars.

While the above list shows various reasons from different perspectives and some reasons mentioned by several scholars, some opinions have not found agreement with others. Generally, the causes of reputational crisis could be summarised into internal and external categories. The internal causes include: product safety incident, human or organizational issues, enterprises' lack of social responsibility (SR) or managers' lapse of ethical standards (ES), financial issues, cultural issues, poor marketing, and poor media relations. The external reasons include false information, misleading information in the media and market deregulation.

Chinese Society Transformation and the Hypotheses

The People's Republic of China was founded in 1949. Mao Zedong took the Soviet style of a centrally planned economy as a positive example to follow (Jefferson and Rawski, 1994). The Marxist-Leninist ideology, a command ideology, led to over-manned state enterprises with low productivity (Warner *et al.,* 2005). In 1978 China was ready for reform, during which the rural economy was de-collectivised, private and semi-private enterprises swelled, and the state sector steadily shrank (Zhang, 2004).

The decentralization of economic control followed the reform with local governments gaining some or all of the decision-making power relinquished by the central government (Jia, 1998). Under the guideline of "focus on economic construction" which was brought up by Deng Xiaoping, the mission of the Chinese enterprise is to shift to making profit, but not to serving the nation any more. The nation, from the constitutional level, announced in 1998 that the private economy is an "important component" of the whole nation's economic system. These reforms altered people's fundamental economic interests (Lu, 2009). In that year, 1998, Chinese institutional reform formally started.

In the late 1970s and the early 1980s, China opened the doors to trade with the outside world (Chow, 2000). The second phase of economic reform occurring in the 1980s was aimed at creating market institutions and converting the economy from an administratively driven command economy to a price-driven market economy (Chow, 2000). This process culminated in 2001 when China became a member of the WTO, which was followed by China's emergence as a leading world economy in the first decade of the 21st century.

Today, a socialist market-economy system has been built up in China, and a profit conscious concept has been rooted in the Chinese mind. Still, China is a country with a one-party political system. Most state-owned enterprises were privatised, restructured, or simply shut down. Meanwhile plenty of joint-venture enterprises and privately-owned companies have been built up rapidly. Over the two decades, China has enjoyed the status of one of the fastest developing countries in the world, with an annual growth rate of 8–10 %, on average (Hampden-Turner & Trompenaars, 2002).

China's "open policy" has been pushing Chinese companies into global competition. Especially since China's entry into the WTO in 2001, Chinese companies have been facing increasingly fierce competition in all fields. Lu (1997) pointed out that development in political and cultural spheres is not increasing at the same speed. Starting in 1998, Chinese institutional reform developed slower than economic reform. A culture of profit began to take root and people began pursuing profit for themselves, very often with socially undesirable consequences (Ip, 2009). Beijing Review (2005) reported that many Chinese companies were found lacking in fulfilling their social responsibilities.

Wartzman (2007) stresses the need to instill in China's business owners and managers that the only way to sustain a business is to make sure they develop a sense of social responsibility.

The contemporary Chinese organisations experienced China's societal circumstance transformation. Meanwhile, existing in this transforming circumstance, Chinese organizations are affected by China's economic, institutional, and ideological transformation. Based on the above literature on causes of reputational crisis and the Chinese societal transformation environment, the author proposes two hypotheses about the causes of reputational crises in Chinese organisations.

Hypothesis 1: The causes of reputational crises in Chinese organisations are mostly related to product safety incident from the internal side of the enterprise.

Hypothesis 2: The external causes of reputational crises in Chinese organisations are mostly related to market deregulation.

Empirical Study

In the following part, the research methods used in this empirical study will be described and discussed. Organizational crises are believed to be highly ambiguous situations where causes and effects are unknown (Dutton, 1986; Quarantelli, 1988). Thus, the author conducting this research aims to discover the causes of reputational crises in Chinese organisations and then to define the connections between these causes and Chinese societal transformation. The research questions are (1) – What are the reasons causing reputational crises in Chinese organisations? (2) – Are these reasons from the internal or external side of the organisation? (3) – How did the Chinese contemporary social environment influence these causes?

Methodology

The following methods, exploratory, descriptive, and explanatory (casual study) approaches were chosen to conduct the research. These methods are believed by the author to be necessary to fulfil the research tasks, test the hypothesis, and lead the correct conclusion. The exploratory approach was used to generalize the hypothesis. The descriptive approach was used to serve the research questions, and the explanatory approach was used to achieve the research aims.

The qualitative method (interview) was used in this research since it enables one to gain a greater knowledge and a deeper understanding of the detailed information about the reasons causing reputational crises in Chinese organisations. The interview questions were formulated in English. They were subsequently translated into Chinese Mandarin to conduct the interview since the interviewees were Chinese natives. The interview questions are divided into two parts. The first part deals with the sample company's information and the interviewee's position. The second part focuses on the content of the crisis that happened in the sample company. It includes the type of crisis, the time of occurrence, the reasons causing it, the handling process, stakeholders, and the impact on the enterprise. The interview questions are listed in the Appendix I.

Following the interviews, a content analysis of the result of the interview was conducted so as to discover the answer to the research questions, i.e. the internal connections between the reasons causing reputational crisis and the Chinese enterprises. The method used to analyse the data was ordinal. The primary data which was gathered via interviews was categorised and ordered. The hypothesis presented before was tested by the result of the analysis.

The Sample

Since the year 2008, 156 interviews have been conducted with middle to top level managers in Chinese companies. The author conducted the interview via telephone or the Internet. The interview lasted from 30 to 90 minutes. For the interviewees who did not understand the meaning of the term "crisis", the author defined it as an event with low probability, serious consequence, and a short response time. The interviewees decided which crisis situations they would describe.

The geographical locations of these companies include Beijing, Guangdong, Jiangsu, Jiangxi, Hebei, Henan, Hubei, Hunan, Inner Mongolia, Shandong, Shanghai, Sichuan, Xinjiang, Zhejiang, and so on, all together 14 provinces and 57 cities. The business areas of the sample companies include agriculture, manufacture, service and entertainment, finance and real estate, education, transportation, medication, technology and telecommunication industries.

All of these companies had experienced a crisis. Through the primary data analysis, it was found that, following an economic crisis, a reputational crisis is the second most frequently occurring crisis among Chinese organisations. The result of the primary analysis of the crisis type is to be found in Appendix II. As the author conducted the interview in the years of 2008 and 2009, during which the global recession started to affect China, the economic crises in Chinese organisations are all related to that. Due to the background of the economic crisis, which is an economic subject rather than a management topic, the author has decided to choose reputational crisis as a study sample, rather than the economic crisis. A total of 29 companies (18.6%) reported that they had encountered a reputational crisis. The author conducted a deeper analysis based on a full study of all 29 cases of reputational crises.

Interview Result

The reasons causing reputational crises involve both internal and external aspects of an enterprise. Among the internal factors, eleven out of twenty-nine companies (37.9%) reported product safety incidents as having caused a reputational crisis, which is the highest frequency among all the caused reasons. Nine companies (31.0%) encountered crises caused by human and organizational issues, which is the second main reason. Eight companies' (27.6%) reputational crises occurred due to a lack of SR or managers' lapse of ES in the enterprises, which is the reason with

Table 2: The causes of reputational crises in Chinese organizations

		Sample	%	Rank
Internal reasons	Product safety incident	11	37.9	1
	Human or organizational issue	9	31.0	2
	Lack of SR or lapse of ES	8	27.6	3
	Financial issues	6	20.7	4
	Cultural issues	3	10.3	5
	Poor marketing	3	10.3	5
	Poor media relation	2	6.9	7
External reasons	False information or misleading information in the media	3	10.3	2
	Market deregulation	5	17.2	1
Single reason		12	41.4	
Dual and multiple reasons		17	58.6	

the third highest frequency. Six companies (20.7%) had financial issues which led to a reputational crisis. Three companies (10.3%) experienced crises caused by cultural issues or poor marketing. Two companies (6.9%) suffered crises because of their poor relation with the media.

Among the external factors, five cases were due to market deregulation, three cases were caused by false information or misleading information in the media. Table 2 lists the reasons causing the crises, the percentage of the total number of reputational crises, and the frequency ranking for each reason. Crises in seventeen companies were caused by dual or multiple reasons, while crises in twelve companies were caused by single reasons.

Based on the results of the interviews, the causes of reputational crises in Chinese organizations were found. Most organisations' reputational crises were caused by dual and multiple internal reasons.

The first internal reason – product safety incident was most often accompanied by the third reason – the enterprise's lack of social responsibility or the manager's lapse in ethical standards (5 companies).

This phenomenon manifests that both the enterprise manager and local government were to blame. Indeed, the radical reasons for such product safety incidents are the lapse of managers' ethical standards and the lack of local government inspection. The enterprises' lack of social responsibility reflects the managers' lapse in ethical standards. Due to the lapse in ethical standards, managers ignore the moral principles, ignore the enterprise social responsibility, and ignore the importance of product safety, and instead, only focus on "making huge short-term profits" (Dowling, 2002).

Most of the product safety incidents spread throughout the country. This also demonstrates that the performance of local governments in fulfilling their duty was insufficient. With regards to local government, one important duty is to direct enterprise development legally via regulation, inspection, examination, and so on. If the local governments perform their responsibilities appropriately, all the product safety incidents could be detected in time. Thus, the serious incidents, such as 48 infants death (case 30), the top managers felony sentence (case 31), and the enterprise bankruptcy (case 30 and 31), could have been avoided, or at least, the impact could have been reduced to the minimum.

This phenomenon has deep causes. The radical changes in the Chinese economy and society result in the old traditional ethical and value system clasp. However, the new ethical and value rules still need time to be built up. Driven by the mission of making profit, some enterprises became confused and even abandoned moral judgment, only focusing on financial profit. Therefore, due to the lapse in ethical standards by the manager, the enterprise incurred a reputational crisis. These product safe incidents indicate that the demand for new ethical and value systems be reinforced.

The second internal reason – human or organizational issues combined with financial problems (5 companies), and cultural issues (3 companies).

During the reform of the Chinese economic system, plenty of enterprises changed ownership and salary systems (Wang, 2006; Alas and Sun, 2007; Sun and Alas, 2007; Sun, 2009). These changes enabled enterprises to face market competition directly, and employees' efficiency at work was directly related to their salary. However, employees who were used to the old salary system and managerial concept could not accept and adapt to the changes immediately. On the one hand, employees' concept of work is still to serve the nation – in most people's minds this was a kind of honour before and during the first several years of the Chinese economic reform. Thus, their salary should be decided by the nation not the enterprise managers. Once they realised they were not serving the nation any more, and even their salary would be decided by the managers of the enterprise they worked for, they felt they had lost their personal value. Naturally, they refused the new salary policy. On the other hand, connecting salary with efficiency at work required employees to perform work skilfully and behave according to a strict working discipline. For those people, who were used to getting a salary with or without little work performance, it was quite difficult to adapt to the new salary policy initially.

From an ideological view, these are due to the acute conflicts between the old and new styles of ethical and value thinking. During this transformational time, enterprise managers and employees' ethical standards are all experiencing a transformation as well as in social ethical standards. The old ethical thinking, of serving the nation and earning a standard salary, conflicted with the new thinking of making profit and earning a competitive salary.

From a cultural aspect, most state owned enterprises changed ownership to multi-ownership, and especially to private ownership, which has caused another type of conflict. Before the ownership changed, a state owned enterprise was a symbol of the nation. State ownership is an honour in Chinese culture, and sharing profit is derived from the former. However, the private business and private ownership were despised in Chinese business culture. Hence, the change from older ownership to multi-ownership and private ownership resulted in a conflict from a cultural aspect – the old ethical and value concepts clash with the newly created ones, which are the reasons causing cultural issues. The drastic clashes have resulted in reputational crises in enterprises.

Conclusion and Implication

Conclusion

Through the analysis in the previous part, the reasons causing a reputational crisis in Chinese organisations are outlined. The hypotheses proposed in the previous part are re-evaluated now.

Hypothesis 1 states that the causes of a reputational crisis in a Chinese organisation are mostly related to product safety incidents from the internal side of the enterprise. This hypothesis was supported. The product safety incidents were the reasons with the highest percentage of all the causes of reputational crises in Chinese organisations.

Hypothesis 2 state the external causes of reputational crisis in Chinese enterprises are mostly related to market deregulation. This hypothesis was supported. Market deregulation was found as the main external reason for reputational crises in Chinese organisations.

To sum up the above two hypotheses, the highest product safety incident rate and market deregulation, as well as the other causes of reputational crises in Chinese organisations, have special deep-seated connections with contemporary Chinese societal transformation. The internal causes of reputational crises in Chinese organisations are following two paths.

Firstly, the transformation of Chinese society finally changed or is changing people's values and ethical standards. During the transforming process, the drastic clashes between old and new values and ethical standards created one path of Chinese organisation reputational crisis, which is considered, too, as a connection between the internal reasons for reputational crises in Chinese organisations and the transformational environment in China.

Secondly, although reform of the Chinese economic system was completed, the value and ethical standard transformation was not achieved. The old value and ethical systems have broken down; however, the new value and ethical standards have not been consolidated. During the time of ethical transformational, the demand for and the absence of

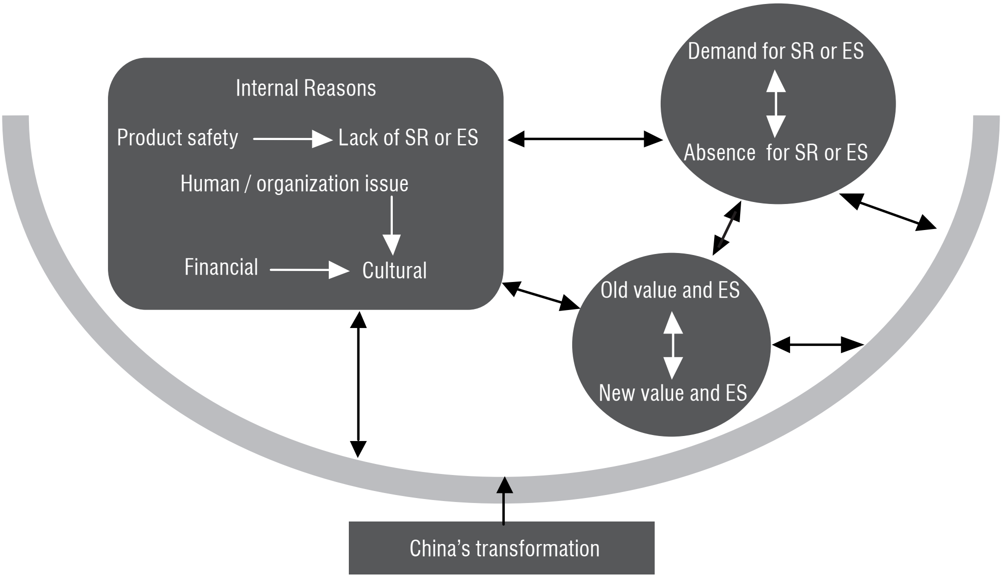

Figure 1: The internal causes of reputational crisis in connection with China's societal Transformation
SR – social responsibility; ES – ethics standards

values and ethical standards conflict fiercely, which is another main cause of reputational crises in Chinese organisations. The author considers it as another connection between the internal reasons for reputational crises in Chinese organisations and the transformational environment in China. Figure 1 shows these connections.

Besides, the internal reasons causing reputational crises in Chinese enterprises show diversity and complexity. This is because during the economic and political reform, Chinese society is a diversified and complex environment.

The external cause, market deregulation, also has its connections with Chinese societal transformation, especially, the institutional transformation. The Chinese economic reform, the policy of opening to the outside, and membership of WTO brought Chinese enterprises to a wholly new competitive market. The new market needs new policies and regulations to direct and control its development orientation. However, the Chinese institutional reform, which started in 1998, develops more slowly than the market's demand for policies and regulation. On the one hand, the old policies and regulations are out of date and can not adopt nor apply to the new market situation. On the other hand, new policies and regulations have not been created or completed. Thus, there is a big gap between the policy and regulation demand of the rapidly developing market and the existing policies and regulations based on the slowly processed institutional reform. This gap made the market deregulation become the main external cause of reputational crises in Chinese organizations.

Implications

The following implications should be considered by enterprise managers, especially managers in Chinese enterprises, when making decisions about the enterprise's development strategy and business direction.

Firstly, with regards to the enterprise manager, especially a top manager, it is important to have a clear ethical and value standard when making decisions on company strategies, development directions and goals.

Reputational crises were frequently caused by product safety incidents, accompanied by a lack of social responsibility in the enterprise or a lapse in lapse of ethical standards by the manager. This fact is an alarming indication of the absence of an ethical standard in managers. Enterprise managers should improve their ethical conscience and strengthen their value thinking so as to have a clear ethical and value standard.

Secondly, with regards to the enterprise, it is important to perform its social responsibility as well as achieve its economic goal.

The economic goal of an enterprise is to obtain profit, which is a demand of stakeholders from the internal side of the enterprise. However, the social responsibility performance is demanded by stakeholders from the external side of the enterprise. The social responsibility performance will directly affect external stakeholders' evaluation of an enterprise, and thus affect its reputation. So, enterprise social responsibility performance is important to enterprise reputation.

Thirdly, with regards to the government, especially local government, it is necessary to provide sufficient and timely direction and supervision for enterprises.

Each level of government should have a defined goal and responsibility towards the enterprises in the corresponding area of administration. From the point of view of policy and regulation, the government should create and clarify the new product quality standard and safety norms, so as to provide the enterprise with a clearly defined guideline to follow in the daily running of its operations. From the point of view of practice and administration, governments should inspect and examine an enterprise's product quality at regular and irregular intervals to ensure that it is firmly and strictly in accordance with regulations. Thus, a method to help and amend enterprises can develop in a healthy way.

To sum up, the management of reputation is generally recognised as the core responsibility of public relations (Kay 1993). However, the reputational crises in Chinese enterprises implied that public relations alone are not enough to fulfil the requirements necessary to maintain the reputation of an enterprise To do so, it needs enterprise managers with a strategic view to improve ethical and value standards, to strengthen enterprise social responsibility performance, and to build public relations. All of this will provide an enterprise with a harmonious external environment to defend it from a reputational crisis attack. From the external side of the enterprise, the government at each level needs to strengthen the direction and supervision of enterprises so at to lead them in a way that harmonises with the economic development.

Limitation and Further Study

This research paper focuses on the causes of reputational crises in Chinese organisations, and discovers the connections between these causes and Chinese society from a sociological perspective. There are many other domains which connect to the causes of reputational crises in Chinese organisations which should be studied in the future. So, to expand the study to a wider perspective, such as cultural and historical views, will provide more angles of observation and more complete conclusions. Furthermore, due to limited data resource, the samples of reputational crises number in total 29. In the future, conducting more empirical research is a way to examine and prove the conclusion.

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Appendix 1

Interview Questions

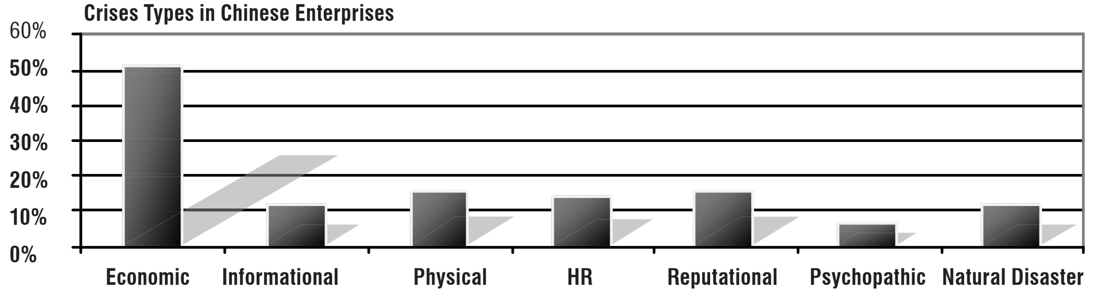
Company name:

1. Number of employees:
2. Industry:
3. Year of establishment:
4. Your position:
   Please describe one concrete crisis in your company, how it happened and how you solved this crisis. Describe the crisis. What happened, what were the results of this crisis?
5. Which type of crisis was it? Is it (mark with "+"):

Economic	Informational	Physical	HR	Reputational	Psychopathic Acts	Natural Disasters

6. How did this crisis start?
7. Did it happen suddenly (abrupt crisis) or was it the result of accumulated stressors that eventually erupted (cumula tive crisis).
8. What was the scope of the crisis, and did it influence the whole company or only some department?
9. Who was impacted by the crisis? Who could feel the consequences of the crisis?
10. Who were the stakeholders, and whose interests did the organization have to consider? Had the organization deter mined stakeholders already before the crisis or only after?
11. Please indicate which stakeholders were considered the most important, the second most important and the third most important.
12. How was the company prepared for the crisis? Did the company determine principles that should be followed while solving the crisis before the crisis started?
13. Had the company formed any documents for solving crises before the crisis? Describe these documents.
14. When were these documents written? Were areas determined where a crisis could happen before the crisis hit? Was the potential of the crisis analysed? Did they form a crisis centre before the crisis? Did they have a crisis plan? Have they been trained how to behave during a crisis?
15. How did the company react when the crisis happened? Please describe in detail.
16. How was the process managed: Who led the process? How were decisions made? How were tasks determined?
17. How would you describe the management style in crisis situations in your company? Which characteristics did the leader need?
18. Describe crisis communication: who was leading the communication? Which messages were sent out? Which channels were used? How were decisions made?
19. What was done to maintain the reputation of the company?
20. What did you learn from implementing these changes? What would you do differently in the future?
21. What would you suggest to others?
22. What were the most important success factors?

Appendix 2



The Innovation Climate – Predictor for Corporate Social Responsibility (CSR)

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Abstract

Organisation climate plays an important role for the innovation of an organisation. Corporate social responsibility is an important management tool in contemporary organisations. The purpose of this paper is to investigate connections between the innovation climate and two facets of corporate social responsibility. A survey was conducted in Estonian, Chinese, Finnish, Czech, Slovakian and Japanese enterprises. ANOVA-test and linear regression analysis were conducted.

The results of an empirical study show that the innovation climate and corporate social responsibility were valued differently in those countries. The social, political, cultural, historical and economic environment where organisations operate, influences the way the innovation climate and corporate social responsibility as concepts are understood, applied and evaluated. The model subsequently developed explains how the innovation climate predicts two facets of corporate social responsibility.

Keywords: innovation climate, corporate social responsibility, Estonia, China, Japan, Finland, the Czech Republic, Slovakia.

Introduction

This paper analyses connections between the innovation climate and two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents in Estonian, Chinese, Finnish, Czech, Slovakian and Japanese electrical-electronic machine, retail and machine-building enterprises.

The main aim of the study is to identify the connections between the two facets of corporate social responsibility and the innovation climate.

Research has called for organisations to be more entrepreneurial, flexible, adaptive and innovative in order to effectively meet the changing demands of today's environment (Orchard, 1998; Parker and Bradley, 2000; Valle, 1999). According to Borger and Kruglianskas (2006) it was found that there were many indications of a strong relationship between the adoption of a CSR strategy in the firm and an effective environmental and innovative performance.

A standardised corporate social responsibility questionnaire comprising 19 items developed by the Denki Ringo research group (Ishikawa *et al*, 2006) was used to explore the two facets of corporate social responsibility. Based on the Innovation Climate Questionnaire by Ekvall *et al*. (1983), the authors developed an Innovation Climate Scale, and both questionnaires were administered in Estonian, Chinese, Finnish, Czech, Slovakian and Japanese electrical-electronic machine, retail and machine-building enterprises.

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A linear regression analysis was used in order to find statistically relevant connections between the two facets of corporate social responsibility and the innovation climate.

The main research question is: Does the innovation climate predict the two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents?

The following section will explore the theoretical framework of the study by presenting an overview of the literature on this topic. This will be followed by a brief discussion of the relationship between the innovation climate and CSR. Then the empirical study will be presented followed by the results and some concluding remarks.

Theoretical Framework

The Innovation Climate

Organisation climate plays an important role for the innovation of an organisation. Ekvall and Ryhammar (1999) have found that there are important connections between innovative organisations and a creative climate.

In this study, we examine the innovation climate that is the degree to which an organisation offers its employees support, and encouragement to take initiative and explore innovative approaches that influences the degree of actual innovation in that organisation (Martins and Terblanche, 2003; Mumford and Gustafson, 1988).

Many authors (Van de Ven, 1986; Amabile, 1988; Smith, 2000; Unsworth and Parker, 2003), have found that individual innovation helps to attain organizational success. Employee innovative behaviour depends greatly on their interaction with others in the workplace (Anderson *et al.,* 2004; Zhou and Shalley, 2003). According to Damanpour and Schneider (2006), the climate for innovation is a direct result of the top managers' personal and positional characteristics.

Ekvall (1999), states that innovative organisations have the capacity to adapt to constantly changing environments in order to survive, and these adaptive organisations require a climate that stimulates creative behaviour. According to Ekvall (1990), innovative organisations score high in the following dimensions – challenge/motivation, freedom, idea-support, trust, dynamism, humour, debate, risk-taking and idea-time. According to Ekvall (1990) and Nyström (1990), a climate that supports innovation can enable its members to generate and implement creative ideas more effectively. Mumford and Gustavson (1988), stated that organizational innovation depends on the climate for innovation.

According to Buckler and Zien (1996) innovation is the purpose of the whole organisation – a broad activity. In this kind of culture, new ideas come forward into an atmosphere of enthusiastic support and a desire to contribute to them, even though everyone knows that the majority of these ideas will not make it to market. Innovative companies are on the lookout to continually refresh this climate, because it can be undermined. Thinking "outside the box" is certainly a major characteristic of an innovative environment (Buckler and Zien, 1996).

Theories of Corporate Social Responsibility (CSR)

Different organisations have formed different definitions of CSR, although there is considerable common ground between them. Today corporate leaders face a dynamic and challenging task in attempting to apply societal ethical standards to responsible business practice (Morimoto *et al.,* 2005). Nowadays corporate social responsibility is an integral part of the business vocabulary and is regarded as a crucially important issue in management (Cornelius *et al.,* 2008; Humphreys and Brown, 2008).

Hillman and Keim (2001) suggested that, when assessing the returns on CSR, it was critical to discriminate between stakeholder management

CSR and social CSR. This is consistent with Baron's (2001) distinction between altruistic and strategic CSR. More specifically, the authors concluded that whereas stakeholder-oriented CSR was positively correlated with financial performance, social CSR was not.

The tendency to invest in companies that practice and report CSR is increasing (Sleeper *et al.,* 2006). Corporate social responsibility forces a repositioning of strategies from being profit-driven organisations to organisations that are interested in the company's influence on social and environmental aspects (Quaak *et al.,* 2007).

According to Alas and Tafel (2008), research about corporate social responsibility could be divided into three categories: *structural research* (van Marrewijk, 2003; Wilenius, 2005), *normative research* (Gatewood and Carroll, 1981) and *developmental research* (Carroll, 1991, Hoffman, 1997, Schwartz and Carroll, 2003, Reidenbach and Robin, 1991). From the structural viewpoint, corporate social responsibility covers three dimensions of corporate action: economic performance, social accountability and environmental management. From the normative viewpoint, different levels of social responsibility, based on the criteria of the extent to which a company meets the social expectations of the society, could be differentiated. From the developmental viewpoint Carroll's (1999) CSR model identifies four components: economic, legal, ethical and voluntary (discretionary). The economic aspect is concerned with the economic performance of the company, while the other three categories – legal, ethical, and discretionary – address the societal aspects of CSR.

According to the theories of CSR, the authors divide corporate social responsibility into two parts and focus on these two major CSR facets – the firm's performance concerning social issues and the firm's respect for the interests of agents. Having more information about these facets could help to better understand corporate social responsibility, and its connection with the innovation climate.

The firm's performance in regard to social issues

Sethi (1975) stated that while social obligation is proscriptive by nature, social responsibility is prescriptive. Jones (1980) stated that corporate social responsibility is the notion that corporations have an obligation to constituent groups in society, other than stockholders and beyond that which is prescribed by law and union contract. Epstein (1987) provided a definition of CSR in his quest to relate social responsibility, responsiveness and business ethics.

According to Frederick (1960) social responsibility in the final analysis implies a public posture toward societies economic and human resources, and a willingness to see that those resources are used for broad social ends, and not simply for the narrowly circumscribed interests of private persons and firms. The proper social responsibility of business is to tame the dragon – to turn a social problem into an economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs and into wealth (Drucker, 1984).

In the 1990s, the concept of the corporate social performance stream emerged (Wood, 1991). Carroll's (1999) CSR model identifies four components: economic, legal, ethical and voluntary (discretionary). The economic aspect is concerned with the economic performance of the company, while the other three categories – legal, ethical and discretionary – address the societal aspects of CSR.

Waddock and Graves (1997) found a positive relationship between a firm's social performance and its financial performance, whereas Wright and Ferris (1997) found a negative relationship. Orlitzky *et al*. (2003), claim that there is strong empirical evidence supporting the existence of a positive link between social and financial performance.

Marcel van Marrewijk (2003) has narrowed down the concept of corporate social responsibility so that it covers three dimensions of corporate action: economic, social and environmental management. Garriga and Mele´ (2004) grouped theories of corporate social responsibility into four groups: instrumental, political, integral and ethical.

The firm's respect for the interests of agents

Stakeholder Theory, popularised by Freeman (1984; 1994), essentially argues that a company's relationships with stakeholders (and treatment of the natural environment) are central to understanding how it operates and adds value as a business. Freeman (1994) argues that stakeholder language has been widely adopted in practice and is being integrated into concepts of corporate responsibility/citizenship by scholars who recognise that it is through a company's decisions, actions and impacts on stakeholders, and the natural environment that its corporate responsibility/citizenship is manifested.

Corporate social responsibility is a concept whereby companies fulfil accountability to their stakeholders by integrating social and environmental concerns in their business operations (Tanimoto, Suzuki, 2005). Companies will necessarily have to take into account cultural differences when defining their CSR policies and communicating to stakeholders in different countries (Bird and Smucker, 2007).

Connections between the Innovation Climate and CSR

Today, pioneering enterprises integrate social entrepreneurship into their core activities by actively channelling their research-and-development capabilities in the direction of socially innovative products and services (Schwab, 2008).

According to Borger and Kruglianskas (2006), it was found that there was considerable evidence of a strong relationship between the adoption of a CSR strategy by the firm and effective environmental and innovative performance.

According to Asongu (2007), the key to success in using any type of innovation to a company's advantage from the CSR perspective is communication with local municipal authorities, the press, and most importantly, the general public that stands to benefit from such initiatives.

Asongu (2007), states that companies that have sustainable policies tend to be technological leaders, as they seek imaginative new methods for reducing pollution and increasing efficiency. In many cases, these companies are able to come out with new, innovative products that out-pace most of their competitors.

According to Phills *et al*. (2008), many social innovations involve the creation of new business models that can meet the needs of underserved populations more efficiently, effectively, and if not profitably, at least sustainably. Many innovations tackle social problems or meet social needs, but the distribution of financial and social value is only tilted toward society as a whole for social innovations. A social innovation can be a product, production process or technology (much like innovation in general), but it can also be a principle, an idea, a piece of legislation, a social movement, an intervention or some combination of them.

Asongu (2007), states that in the course of pursuing CSR initiatives, some companies have developed very innovative products and services that are beneficial to the company's profitability. It is possible for a company to become more innovative as an unintended concomitant to a CSR initiative. Innovation will also include the serendipitous identification of more efficient methods of doing business or new types of products or services that may not have occurred to a business if it has no CSR initiatives in the first place.

Manning (2004) reports that an innovation that could satisfy the needs of the local community represents such an opportunity for using CSR to a company's advantage; again providing that the otherwise strictly altruistic nature of the enterprise is not lost on the company's consumers and potential consumers.

According to Stigson (2002), more and more companies are adopting CSR approaches to help ensure efficiency, stimulate innovation and create continued organizational growth.

Innovative companies are thinking and acting in terms of a 'triple-bottom-line' ethic, which goes well beyond the drive to maximize shareholder value by incorporating environmental quality and social justice considerations into their business decisions (Larsen and Peck, 2001).

According to Asongu (2007), corporate leaders today can take advantage of unexpected opportunities to use the results of their CSR initiatives in innovative ways. Because innovations can span the entire range of a company's operations, the manner in which CSR initiatives can be used to accomplish them are virtually limitless, and are constrained only by the imaginations of the players involved.

Based on the relevant literature we developed the following general propositions:

P1. The innovation climate and the two facets of corporate social responsibility are evaluated differently in the Chinese, Japanese, Estonian, Finnish, Czech and Slovakian enterprises.

P2. The innovation climate predicts the two facets of corporate social responsibility in the Chinese, Japanese, Estonian, Finnish, Czech and Slovakian enterprises.

Empirical Study

The authors of this article conducted their empirical study in 2007–2008 in order to find connections between the innovation climate and the two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents – in the Estonian, Chinese, Finnish, Czech, Slovakian and Japanese enterprises. These two facets of corporate social responsibility were chosen because they typify the essential character of CSR.

The author obtained the file with the Chinese, Japanese, Finnish, Slovakian and Czech respondents' answers from the Japanese co-partner of the Denki Ringo (Ishikawa *et al*, 2006) research group. The author made contact with a member of the board in Estonian organisations and obtained permission to conduct this study. After that the questionnaire was sent by e-mail to the respondents in each enterprise. The answers were also sent back by e-mail.

The research was conducted with 623 respondents in the Estonian enterprises, 1150 in the Chinese enterprises, 1110 in the Czech enterprises, 605 in the Slovakian enterprises, 239 in the Finnish enterprises and 1570 in the Japanese enterprises.

There were 6 enterprises from Estonia, 6 from China, 6 from the Czech Republic, 3 from Slovakia, 4 from Finland and 6 from Japan in the study. There were 31 enterprises all together. Approximately 200 employees were working for the companies that were chosen for the study.

In order to identify differences between other countries according to innovation climate and corporate social responsibility China, Japan, Estonia, Finland, the Czech Republic and Slovakia were selected. The selected countries social, economic, cultural, historical and political environment was different, which enabled us to analyse the differences between those countries.

The companies were selected in a non-random manner, as the organisation registers do not have a solid basis for random sampling because only a fraction of the registered enterprises are active in Estonia, China, Japan, Finland, Slovakia and the Czech Republic. The total number of respondents was 5297.

Methodology A standardised corporate social responsibility questionnaire comprising 19 items was developed by the Denki Ringo research group (Ishikawa *et al*, 2006) and translated from English into Estonian, Chinese, Czech, Finnish, Slovak and Japanese. The questions in the survey addressed 2 facets of corporate social responsibility – the firm's performance concerning social issues (11 items) and the firm's respect for the interests of agents (8 items). The questionnaire was administered in Estonian, Chinese, Czech, Finnish, Slovakian and Japanese electrical-electronic machine, retail and machine-building enterprises. The authors conducted the survey in the Estonian enterprises themselves by making contact with a member of the board and getting permission to conduct the study. After that the questionnaire was sent by e-mail to the respondents in each enterprise, and the answers were also returned by e-mail. Then the answers from the Chinese, Japanese, Finnish, Slovakian and Czech respondents were collected by their Japanese co-partner and coordinator of the study.

The authors then developed an innovation climate scale based on the Innovation Climate Questionnaire prepared by Ekvall *et al*. (1983). Items to measure the innovation climate were selected. The internal consistency or Cronbach Alpha coefficient was 0.70. The final version of the questionnaire for measuring innovation consisted of 14 items. Ekvall's (1983) innovation climate questionnaire (ICQ) incorporates thirteen scales: commitment, freedom, idea-support, positive relationships, dynamism, playfulness, idea-proliferation, stress, risk-taking, idea-time, shared view, pay recognition and work recognition.

The data about the innovation climate, the two facets of corporate social responsibility and six different countries – Estonia, China, the Czech Republic, Slovakia, Finland and Japan – were compared by means of an ANOVA-test. The linear regression analysis was used in order to find statistically relevant connections between the two facets of corporate social responsibility and the innovation climate.

The main research question is: Does the innovation climate predict the two facets of corporate social responsibility?

Results

Our main purpose was to evaluate the connection between the innovation climate and corporate social responsibility. The authors used a linear regression analysis. In the analysis the innovation climate is taken as an independent variable and two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents – are taken as dependent variables. We calculated a standardised regression coefficient Beta, which enabled us to predict how strongly the innovation climate predicts corporate social responsibility. The analysis was applied separately for the two facets of corporate social responsibility and for the innovation climate.

The Innovation Climate

There are some similarities and also differences concerning the opinions of the respondents in different countries about the innovation climate.

Table 1 shows the opinions of the respondents on the innovation climate. The statements were rated high in the Chinese (m=3.56, sd=1.05) and Estonian enterprises (m=3.53, sd=0.98), and low in the Japanese (m=3.01, sd=0.93) and Finnish enterprises (m=3.01, sd=1.02).

Table 1. The innovation climate in Estonia, China, Japan, Finland, the Czech Republic and Slovakia

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	SUM
China N=1150	M	3.94	4.45	2.82	2.82	3.20	2.76	3.30	3.87	3.61	3.04	3.80	3.83	4.14	4.24	**3.56**
	SD	0.88	0.92	0.45	1.28	0.94	1.21	1.24	1.12	1.18	1.33	1.09	1.10	1.01	0.91	**1.05**
Japan N=1570	M	2.94	3.53	2.63	2.67	2.81	3.03	3.02	2.75	3.07	3.09	3.20	2.54	3.19	3.59	**3.01**
	SD	0.88	1.09	0.55	0.91	0.88	0.90	0.81	0.82	0.83	0.98	0.90	0.84	2.70	0.83	**0.93**
Estonia N=623	M	3.71	4.40	2.78	3.58	3.37	3.79	3.35	3.39	4.04	2.86	2.92	3.37	3.56	4.23	**3.53**
	SD	0.75	0.67	0.49	0.96	0.98	1.11	0.99	1.40	0.92	1.27	0.88	1.41	0.97	0.98	**0.98**
Finland N=239	M	2.66	3.88	2.93	2.98	3.19	2.98	2.73	2.70	3.07	2.20	3.02	2.50	3.38	3.92	**3.01**
	SD	1.01	1.03	0.31	1.05	1.08	0.92	1.09	1.14	1.18	1.10	1.03	1.17	1.19	1.02	**1.02**
The Czech Republic N=1110	M	3.33	4.23	2.60	3.01	3.03	3.10	3.32	3.00	3.45	2.83	3.29	2.98	3.41	4.03	**3.26**
	SD	1.01	1.00	0.60	1.16	1.16	1.10	1.06	1.14	1.19	1.29	3.36	1.18	1.15	1.03	**1.24**
Slovakia N=605	M	2.50	4.06	2.73	3.02	2.98	2.81	2.84	2.75	3.29	2.86	3.15	3.07	3.91	4.31	**3.16**
	SD	1.01	1.05	0.51	1.03	0.96	1.16	1.10	1.17	1.21	1.36	1.18	1.22	1.20	1.01	**1.08**

Notes: All indicators are statistically different between countries according to the ANOVA-test, $p < 0.05$

Notes: 1 - How do you think you are valued at work, 2 - What do you feel about the firm you are working for (a five-point scale was used, where 1 signifies I don't care for the firm and 5 signifies I would put maximum effort towards the firm's success), 3 - Have you attended courses or seminars organised by the firm inside or outside in the last five years, 4 - The rules of the firm are occasionally disobeyed when an employee thinks it would favour the firm, 5 - Our organisation relies more on horizontal control and coordination, rather than strict hierarchy, 6 - Most capable persons commit in decisions to solve an urgent problem, 7 - Fresh creative ideas are actualised on time, 8 - Current vision creates stimuli for workers, 9 - Company realises a clear mission that gives meaning and sense to work, 10 - If the department is short on hands, the department's head may hire temporary workers himself, 11 - Our organisation cares even about temporary hired workers, 12 - We can all clearly imagine the future of our organisation, 13 - Failure is considered as a stimulus to learning and development, 14 - All the employees should be aware of the important role of their firm in society; a five-point scale was used, where 1 signifies **not at all** and 5 signifies **fully.**

Table 2: The firm's performance concerning social issues in Estonia, China, Japan, Finland, the Czech Republic and Slovakia

		1	2	3	4	5	6	7	8	9	10	11	SUM
China N=1150	**M**	4.11	3.96	4.15	4.15	4.20	4.36	4.38	4.30	4.11	3.99	4.06	**4.15**
	SD	0.95	1.09	0.99	0.99	0.97	0.89	0.86	0.90	0.97	1.03	1.03	**1.02**
Japan N=1570	**M**	3.82	3.43	3.51	3.51	3.56	3.71	3.70	3.51	3.24	2.98	2.97	**3.44**
	SD	0.91	1.06	0.83	0.83	0.81	0.84	0.89	0.87	0.85	0.92	0.93	**0.89**
Estonia N=623	**M**	4.37	4.11	3.98	3.98	4.54	4.22	4.40	4.29	3.33	3.21	2.88	**3.95**
	SD	0.80	0.95	1.12	1.12	0.62	0.85	0.71	0.77	1.14	1.09	0.96	**0.84**
Finland N=239	**M**	3.99	4.18	3.58	3.58	4.02	4.14	4.16	3.34	3.22	2.75	2.89	**3.62**
	SD	0.96	0.95	0.88	0.88	0.93	0.92	0.87	0.86	0.90	0.84	0.82	**0.91**
The Czech Republic N=1110	**M**	4.18	4.64	4.20	4.20	3.64	3.57	4.11	3.73	4.62	4.58	3.16	**4.00**
	SD	0.99	0.52	0.80	0.80	0.67	0.57	0.47	0.44	0.93	0.83	0.93	**0.86**
Slovakia N=605	**M**	3.91	3.80	4.05	4.05	4.07	4.07	4.12	3.90	3.56	3.28	3.21	**3.80**
	SD	0.98	0.98	0.88	0.88	0.93	0.86	0.87	0.95	0.99	1.08	1.08	**0.87**

Notes: All indicators are statistically different between countries according to the ANOVA-test, $p < 0.05$

Notes: The firm's performance concerning social issues: 1 – compliance with the laws for business activities; 2 – compliance with the laws for worker protection; 3 – care and service for consumers; 4 – environmental protection; 5 – trustful relations with customers; 6 – safety and security of products and services; 7 – realisation of the best quality of products and services; 8 – aftercare for users; 9 – publicity of company information for society; 10 – contribution to science and culture; 11 – public activities for the local community; a five-point scale was used, where 1 signifies **not at all** and 5 signifies **fully.**

Corporate Social Responsibility

The firm's performance concerning social issues

In the different countries the respondents estimate statements about the firm's performance concerning social issues differently.

Table 2 shows the opinions of the respondents on the firm's performance concerning social issues. The statements were rated high in the Chinese enterprises (m=4.15, sd=1.02), and low in the Japanese (m=3.44, sd=0.89) and Finnish enterprises (m=3.62, sd=0.91).

The firm's respect for the interests of agents

In the different countries the respondents also evaluate statements concerning the firm's respect for the interests of agents differently.

Table 3 shows the opinions of the respondents on the firm's respect for the interests of agents. The statements were rated high in the Czech enterprises (m=4.27, sd=0.73), and low in the Estonian enterprises (m=3.23, sd=1.26). Finnish respondents did not answer the fifth question.

In summary the statements about the innovation climate and the two facets of corporate social responsibility were rated high in the Chinese enterprises. The statements about the firm's respect for the interests of agents were rated high in Japan. The statements about the firm's performance concerning social issues were rated high in Estonia and Finland. The statements about the two facets of corporate

Table 3: The firm's respect for the interests of agents in Estonia, China, Japan, Finland, the Czech Republic and Slovakia

		1	2	3	4	5	6	7	8	SUM
China N=1150	**M**	4.28	4.07	4.33	3.85	3.69	3.69	3.98	3.96	**3.98**
	SD	0.88	0.85	0.86	1.08	1.12	1.15	0.93	1.03	**1.06**
Japan N=1570	**M**	3.74	3.41	3.88	3.44	3.06	3.03	3.19	3.13	**3.82**
	SD	0.82	0.86	0.91	0.91	0.93	0.91	0.84	0.89	**0.87**
Estonia N=623	**M**	4.26	3.51	3.83	2.91	3.54	2.42	2.76	2.64	**3.23**
	SD	1.21	1.38	1.33	1.35	1.41	1.40	1.28	1.36	**1.26**
Finland N=239	**M**	4.44	3.02	3.69	4.19	-	2.45	2.68	2.77	**3.32**
	SD	0.98	1.10	1.12	0.96	-	0.98	0.90	0.95	**0.96**
The Czech Republic N=1110	**M**	4.37	4.85	3.29	3.40	4.57	4.87	4.55	4.28	**4.27**
	SD	0.54	0.77	0.70	1.20	0.77	0.41	0.79	0.57	**0.73**
Slovakia N=605	**M**	4.10	3.81	3.95	4.15	3.30	3.37	3.69	3.66	**3.75**
	SD	0.91	0.85	0.90	0.93	1.06	1.08	0.98	0.98	**0.97**

Notes: All indicators are statistically different between countries according to the ANOVA-test, $p < 0.05$
Notes: The firm respects the interests of the following agents: 1 – customers; 2 – subsidiary, subcontracting firms; 3 – consumers; 4 – stock holders; 5 – employees; 6 – trade unions; 7 – public administrations; 8 – the local community; a five-point scale was used, where 1 signifies **not at all** and 5 signifies **fully.**

Table 4: How does the innovation climate predict the two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents – in Estonia, China, Japan, Finland, the Czech Republic and Slovakia (according to the standardised regression coefficient Beta).

	B	Beta	T	Sig.
THE FIRM`S PERFORMANCE CONCERNING SOCIAL ISSUES				
CHINA				
N=1150, R^2=.077, F(1.1148)=97.124,p<.000	.169	.279	9.855	.000*
JAPAN				
N=1570, R^2=.292, F(1.1568)=650.18,p<.000	.466	.541	25.498	.000*
FINLAND				
N=239, R^2=.069, F(1.237)=18.685,p<.000	.165	.270	4.322	.000*
ESTONIA				
N=623, R^2=.221, F(1.621)=178.41,p<.000	.401	.472	13.357	.000*
THE CZECH REPUBLIC				
N=1110, R^2=.029, F(1.1108)=34.771,p<.000	.117	.174	5.896	.000*
SLOVAKIA				
N=605, R^2=.193, F(1.603)=145.78, p<.000	.441	.401	12.073	.000*
THE FIRM`S RESPECT FOR THE INTERESTS OF AGENTS				
CHINA				
N=1150, R^2=.063, F(1.1148)=78.980,p<.000	.193	.253	8.887	.000*
JAPAN				
N=1570, R^2=.186, F(1.1568)=361.43,p<.000	.466	.432	19.011	.000*
ESTONIA				
N=623, R^2=.098, F(1.621)=69.254,p<.000	.144	.316	8.321	.000*
FINLAND				
N=239, R^2=.051, F(1.237)=13.880,p<.000	.235	.167	3.725	.000*
THE CZECH REPUBLIC				
N=1110, R^2=.079, F(1.1108)=96.691, p<.000	.378	.283	9.833	.000*
SLOVAKIA				
N=605, R^2=.086, F(1.603)=57.980, p<.000	**.337**	**.296**	**7.614**	**.000***

Notes. * - coefficient statistically significant, p<0,01
According to the results, the innovation climate predicts two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents – in Estonia, China, Japan, Finland, the Czech Republic and Slovakia.

social responsibility were rated high in the Czech Republic and Slovakia.

Connections between the Innovation Climate and Corporate Social Responsibility

There are similarities and differences concerning the connections between the innovation climate and corporate social responsibility in different countries.

From this study the innovation climate predicts two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents – in all six countries (Table 4).

Conclusions

In this article, a theoretical model of the relationship between the innovation climate and two facets of corporate social responsibility – firm's performance concerning social issues and the firm's respect for the interests of agents – was developed and tested. The findings of this study contribute to our understanding of the connection between these theoretical constructs.

In different countries, corporate social responsibility and the innovation climate as concepts are understood and applied differently in organisations. The social, political, cultural, historical and economic environment where organisations operate influences how employees value and evaluate the innovation climate and corporate social responsibility.

According to the results, the innovation climate predicts two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents – in Estonia, China, Japan, Finland, the Czech Republic and Slovakia (Figure 1).

The propositions discussed at the beginning of the paper will now be re-evaluated:

P1. Postulated that the innovation climate and the two facets of corporate social responsibility are evaluated differently in the Chinese, Japanese, Estonian, Finnish, Czech and Slovakian enterprises. This proposition was supported by the findings. The statements about the innovation climate and the two facets of corporate social responsibility were rated high in the Chinese enterprises. The statements about the firm's respect for the interests of agents were rated high in Japan. The statements about the firm's performance concerning social issues were rated high in Estonia and Finland. The statements about the two facets of corporate social responsibility were rated high in the Czech Republic and Slovakia.

The Czech Republic and Slovakia have had a similar social, political, cultural, historical and economic environment. Estonia and Finland have also been similar in this respect in recent decade. However, China and Japan have been different. The Czech Republic and Slovakia were influenced by the Soviet Union before joining the European Union in 2004. The cultural environment is similar in Estonia and Finland, but the social, political and economic systems only began to resemble each other after Estonia regained its independence and joined the European Union.

Maitland and Umezu (2006), state that in Japan the protection of stakeholders-especially employees-has largely devolved upon companies (hence "stakeholder companies") by historical design. Aoki (1988), states that the Japanese company is a coalition of the body of stockholders and the body of employees, integrated and mediated by management. It is consistent with the results of the current study where the statements about the firm's respect for the interests of agents were rated high in Japan.

Linfei and Qingliang (2009), stated that CSR in China is better than before and those enterprises that perform positively in CSR enhance its economic and social performance. It is consistent with the results of the current study that shows that the Chinese respondents evaluated highly the statements about corporate social responsibility.

P2. Postulated that the innovation climate predicts the two facets of corporate social responsibility in the Chinese, Japanese, Estonian, Finnish, Czech and Slovakian enterprises. This proposition was supported by the findings. The innovation climate predicts the two facets of corporate social responsibility in the Chinese, Japanese, Estonian, Finnish, Czech and Slovakian enterprises.

According to study results these organisations where climate for innovation is valued highly are more likely to take into account the laws for business activities, worker and environmental protection. These organisations tend to have trustful relations with customers and they take care of consumers. They care about the safety and security of products and services. They tend to ensure the best quality of products and services. They provide aftercare for users. They publicise company information for society. These companies contribute more to science and culture. They also organise public activities for the local community.

These organisations where climate for innovation is valued highly take more care of the interests of the following agents: customers, subsidiary, subcontracting firms, consumers, stock holders, employees, trade unions, public administrations and the local community according to study results.

Our findings are consistent with the following studies:

Some corporate leaders now see CSR as part of their strategic management program, while others see it as a source of innovation (Allen and Husted, 2006). According to Borger and Kruglianskas (2006), it was found that there were many indications of a strong relationship between the adoption of a CSR strategy by the firm, and an effective environmental and innovative performance. Today, pioneering enterprises integrate social entrepreneurship into their core activities by actively channelling their research-and-development capabilities in the direction of socially innovative products and services (Schwab, 2008). Asongu (2007), states that companies that have sustainable policies tend to be technological leaders, as they seek imaginative new methods for reducing pollution and increasing efficiency. In many cases, these companies are able to come out with new, innovative products that out-pace most of their competitors.

Summarising the above, the innovation climate predicts the two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents – in all six of the evaluated countries.

The social, political, cultural, historical and economic environment where organisations operate influences the way corporate social responsibility and the innovation climate as concepts are understood and applied. The innovation climate and both facets of corporate social responsibility - the firm's performance concerning social issues and the firm's respect for the interests of agents are valued and evaluated differently in Estonia, China, Finland, the Czech Republic, Slovakia and Japan.

Implications for managers:

Through the identification of CSR strategy, managers are in a better position to understand the innovative performance of the employees in the organisation. Managers can be more successful in creating an innovative environment in the organisation, when they have a clear understanding of the indicators that influence it.

There is a relationship between corporate social responsibility and the innovation climate. National cultures influence connections between the innovation climate and the two facets of corporate social responsibility – the firm's performance concerning social issues and the firm's respect for the interests of agents. In different countries different types of culture dominate.

The innovation climate is a complex entity and it predicts the firm's performance concerning social issues and the firm's respect for the interests of agents. Therefore, managers should be aware of these influences when they create an innovative climate in an organisation.

Limitations of the study:

Although some useful conclusions and implications have been drawn, it should be stressed that such complex phenomena as corporate social responsibility and innovation climate can only be touched upon in one article. There are limitations to this study connected with its general framework. The author explored concrete connections between a limited number of factors, and the other influences have been left for further research. Besides the importance of connection between corporate social responsibility and the innovation climate, other factors like ethics and leadership could also be taken into consideration. Different leadership styles should be analysed concerning the application of CSR strategy and the management of innovations. Business ethics should also be analysed according to corporate social responsibility and innovation.

This research project was conducted in both private and public organisations. But the research results cannot be generalised for both sectors, because the amount of research completed in public organisations was limited. The questionnaires were conducted in Estonian, Chinese, Finnish, Czech, Slovakian and Japanese electrical-electronic machine, retail and machine-building enterprises. In this case the enterprises branches were not representative of the whole business field. In order to obtain more information about the influence of the institutional stage upon the connection between corporate social responsibility and the innovation climate, comparative studies could be undertaken in other countries such as the USA, other European countries and Australia. Attention should also be turned to other industries, and studies should also be conducted in multinational organisations.

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Appendix

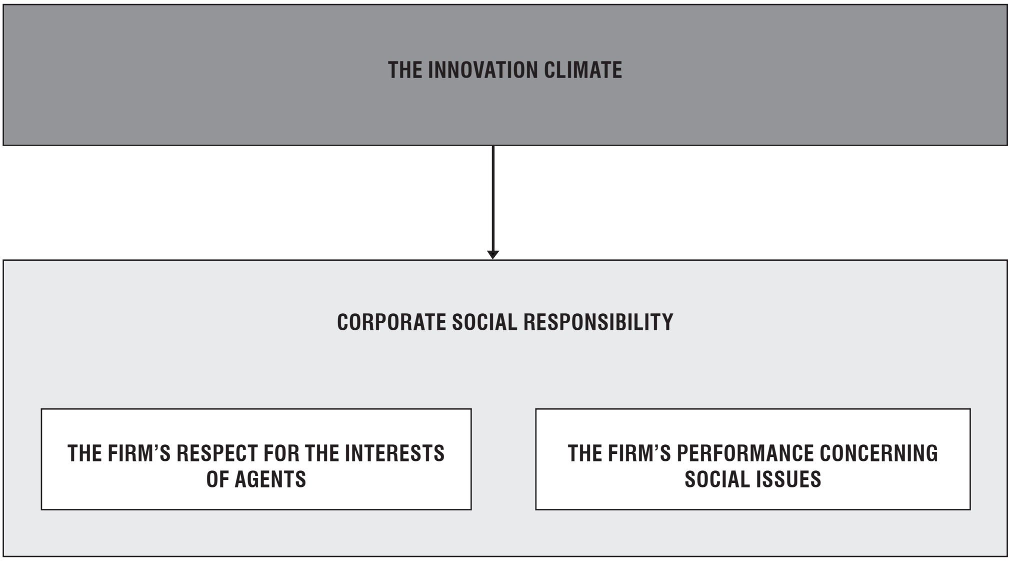

Figure 1: Innovation climate predicting corporate social responsibility in Estonia, China, Japan, Finland, the Czech Republic and Slovakia

Public and Private Sector Cooperation in Estonia: Background and Perspectives

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Introduction

The topic of public and private sector cooperation has gained the interest and attention of both researchers and governments in various countries for a long time. It is also intriguing to researchers, since a solution must be found for the different interests and needs in the traditional model of social management, in order to combine them into a balanced whole. Governments see the implementation of public and private sector cooperation as an opportunity to involve supplementary resources, in order to satisfy the rapidly changing needs of society and to accelerate the development of many spheres of community life. At the same time, governments have to consider many risks, and during stable development, there is a reluctance to take these risks. Problems can arise as a result of the researchers in the field and the governments having not cooperated sufficiently to ensure that the different forms of public and private sector cooperation which rely on theoretically ordered foundations and the legal and administrative peculiarities of each specific country are taken into account. Adopting the experiences of other countries without critical analysis can produce the opposite result and create political risks for the actions of the government.

In this article, the authors will provide a short overview of the main theoretical foundations of public and private sector cooperation; related experiences of other countries will be analysed, and proposals presented for the implementation of public and private sector cooperation in Estonia. This topic has not been sufficiently researched in Estonia. Therefore, we have no accepted model of implementation for these projects. The main goal for this initial research was to elaborate on the theoretical background of public and private sector cooperation, and establish the main foundations of the implementation model from the legal environment. The next phase of the research will evaluate the outcome of the different stages of the model including the economic and taxpayer perspective.

The authors Murumägi and Sahk have conducted research on the given topic within the framework of the research at EBS on the Development of Public Administration Organisations and their Legal Framework: Application of Experience in New Democracies (see Murumägi, 2007 and Sahk, 2008).

Methodology

The presentation of the positions in this article is based on the theoretical sources in the field, and the results of analysing the relevant treatment of legislation and international organ-

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isations. Thereupon, an evaluation has been made of the opportunities provided by the established judicial area, and the possibilities for implementing public and private sector cooperation projects in Estonia, taking practical requirements into consideration. In order to ascertain the current state of prospects for and the restrictions related to these projects, numerous interviews and surveys were conducted during 2007-2008 with Estonian businesspeople, government officials dealing with this field of activity, and the leaders and officials of local government units. These interviews and questionnaires provided a supportive role to the main analysis.

In brief this is an action research with the aim of systematically collecting research data on functional cooperation systems, considering the variation of different variables, on the basis of hypotheses and the applied evaluation of results obtained through the collection of additional data.

Theoretical Background – Combining Public and Private Interest

Due to political constraints (Lane, 1996: 82), the public sector must find a volume and extent of service provision that corresponds to the widest possible interests under conditions of limited resources (Eskildsen, Kristensen and Juhl, 2004). Fulfilling and measuring the objectives of public organisations is complicated, which in turn reduces their incentive to act (see Laffont and Tirole, 1991; Tirole, 1994). The private sector, on the other hand, is free to realise its objectives, based primarily on the need to maximise profits. Therefore, we are dealing with increasing private interests or individual wellbeing, which is expressed by effective, creative and dynamic management of capital, as well as professionalism and enterprise (Scharle, 2002). Under conditions of a market economy conditions, the freedom of private sector organisations is guaranteed by the legal order created by the public authorities, in which private autonomy is the central principle regulating relations under private law.

The objective of the New Public Management model[1] is to find opportunities to make public management more productive, while focusing simultaneously on increasing its effectiveness and assessing its results. Another important feature of this model is that the strengthening and purposeful implementation of inter-sector cooperation is considered an important means of administration. Organisations often lack sufficient knowledge to provide the highest quality services or create products in fields of activity where they operate or which are demanded of them. The necessary resources, knowledge, money, information, personnel and management are divided among various organisations. The exchange of resources is necessary to fulfil objectives, make investments and resolve social problems (Astley and Fombrun, 1983). The interdependence of such organisations results in an increased need for cooperation that enables the organisations to retain their autonomy while limiting or optimising expenditures. As a result, the importance of hierarchical power and management relations in society are reduced and the ratio of horizontal relations is increased (Castells, 1993). This in turn strengthens the cohesion of various organisations in the society and increases the society's reserve of strength during stable development as well as in crisis, which develop for various reasons and in various fields of activity.

Under conditions of balanced social management, where the organisations of various sectors of society operate based on the principles of partnership, public and private organisations can find synergetic forms of cooperation by realizing various interests. The beginnings of inter-sector cooperation date back to antiquity (UN/ECE, 2000: 5; Wettenhall, 2005: 25-26).

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[1] *New Public Management* is a model of administrative management that combines tradition public administration with business management and is based on a neoliberal understanding of the state and economy, by favoring the introduction of private sector business and market principles as well an management techiques into the public sector (for more, see Drechsler, 2005).

During the last twenty years, the subject of public and private sector cooperation in the provision of public services has become more topical in various countries, and it has been discussed in many scientific publications (Zarco-Jasso, 2004). Various countries in the world have recently carried out public and private sector cooperation projects, for the development and operation of infrastructure as well as in other fields of economic activity. The need for carrying out such projects is motivated on the one hand by a shortage of financial resources in the public sector, and on the other hand, by the wish to increase the quality and efficiency of public services (EC, 2003a: 4).

Do the forms of public and private sector cooperation compete or do they complement each other?

In theoretical professional literature, one most often finds discussions of various forms of cooperation such as privatisation, contracting-out, and public-private partnerships. These forms of cooperation can generally be defined as follows:

Privatisation

In the European context, privatisation is the transfer/sale of public property to private sector companies, accompanied by the loss of direct control over the production of goods or provision of services (Donahue, 1989: 7). The reasons for this are pragmatic, and are based on the fact that the dynamics of private ownership are better suited to the achievement of objectives (Grahovac, 2004: 140).

Privatisation requires a diverse plan of action on the part of the state, which includes the redefinition of the state's role as owner, large-scale legal deregulation, independent management and development of the economy, as well as the state's cooperation with legal persons governed by private law. At the same time, the state retained a role in and social responsibility for the development of a sustainable economic environment. Such reforms are complicated and their implementation depends on the time and the necessity, as well as the readiness and possibilities of the specific society (for more, see UN, 1999: 13- 18).

In developed countries, the privatisation of companies was initiated during periods when economic effectiveness declined (for more, see UN, 1999: 10-15), thereby reducing the state's economic functions, since the state cannot compete with private enterprise due to the multiplicity of its tasks (Vasiljevic, 2004: xv). Instead of participating in a competitive market, the state gives its enterprises to the private sector and retains the role of establishing market rules and exercising control over the legitimacy of the privatisation *(ibid.).*

At the same time, the state must regulate issues related to the prevention of monopolies in the private sector. As a whole, privatisation is a complicated process that can be productive only in a well-functioning economic environment and under stable legal conditions. At the same time, it should be considered that privatisation may be accompanied by serious social effects, and therefore, the transparency and monitoring of the entire process is important (Grahovac, 2004: 137). Privatisation has been used in more than a hundred countries to increase the volume and quality of the provision of public services – most frequently in the former Soviet Union and the countries of Central and Eastern Europe (Li and Akintoye, 2003: 3; NG, 2000). There is no generalised or systematic overview of the privatisation practices carried out in these countries., Although, based on examples of the practices, one can state that disregarding the aforementioned requirements during privatisation has caused disproportionate social stratification in several countries (Russia, Ukraine) and significantly increased the corruption index of these countries (see Transparency International Global Corruption Reports). As a result, the goal of achieving social cohesion is being replaced by a process of alienation from society, which in turn creates an unstable political and economic environment for development in these countries.

Contracting out

Contracting out is defined as the contractual transfer of the provision of public services to businesses or third sector organisations, whereby the public sector guarantees the service provision by maintaining both the supervisory and financing functions for the services (Altnurme, 2002: 15). According to Estonia's legal order, the contractual transfer of the state's functions to local government units is also treated as contracting out. This is often utilised for the provision of services that are labour-intensive (Hall, 1998). This form has its critics as well as supporters (Butler, 2007).

In contracting out, the public sector units retain control over the definition and selection of services, the administration of the contract, and the evaluation of the service provider's activities (Jensen and Stonecash, 2005). The goal is to provide better services while not restricting the state's areas of influence or responsibility in the provision of services. Contracting out provides an opportunity to provide services at the lowest possible price (for more, see Domberger and Jensen, 1997), but it is the state's obligation to monitor the quality of the services, and prevent possible infringements of public interest during the provision of these services. The contract for the provision of the services specifies the instruments of control assigned to the contracting-out party.

There is no generally recognised theory regarding contracting out, but various studies dealing with public sector reform (see, for instance, Domberger and Piggott, 1986) mention the following reasons for the efficiency of contracting out: the existence of competition between the service providers, additional stimuli for the service providers, and the service providers' continued ownership relations with the service (Jensen and Stonecash, 2005). The authors believe that this is a powerful management instrument, which helps the government to save on costs and increase the efficiency of services, since competition develops between the possible service providers, and private companies are not bound by political agreements. It has been asserted that at the local level, the practice of contracting out has produced an average financial gain of 20% (Jensen and Stonecash, 2005; Domberger and Jensen, 1997).

For contracting out to be successful, large-scale preparations are required from the public organisation that is doing the contracting out. J. Prager (1994) states that contracting out is advantageous in the long term, only if the party doing the contracting out does not have economies of scale, and the executor does not have economies of scope; if the party doing the contracting out cannot efficiently provide the service, if the contracting out creates ex ante competition and if the party doing the contracting out successfully controls the executor. When contracting out, the factors related to the fulfilment of assignments must definitely be considered. These include the priority of the task for the institutions, the public interest, the opinions of interest groups, existence of authorisation norms in the law and discretion. Only then can the financial benefit to be gained from contracting out be considered. If only the financial benefits are considered, the state loses the opportunity to assess the productivity and impact of other non-measurable factors. For contracting out to be successful, an important role is played by the terms and conditions of the contract that is drawn up, and the mutual guarantees as well as controls and coordination mechanisms that are prescribed.

Public-Private Partnership

Public-private partnership is a contractual agreement based on a reciprocal commitment between public and private sector organisations for the joint provision of public services (Bovaird, 2004; Jamali, 2004; Williamson, 1985; Payson and Steckler, 1996; Savas, 2000). Compared to privatisation and contracting out, PPP is a new approach since the cooperation is based on the equality and independence of the parties. The public authority repositions itself from a regulator of the operating environment to an equal partner for the private sector organisation.

In literature, the concept of PPP is often confused with the concepts of outsourcing, privatisation and contracting out. However, PPP contracts should primarily be understood as partnership projects between the public and private sector, while contracting out and privatisation should be regarded as non-PPP contracts.

Continual flexible cooperation, the sharing of risks, incl. financial, democratic and political risks, is important in PPPs (see also Ham and Koppenjan, 2001: 598; Collin and Hansson, 2000: x; Pongsiri, 2002; Chang, 1999; Linder, 1999; Teisman and Klijn, 2002; Lewis, 2002; The World Bank, 2003). In a partnership, each partner has definite advantages over the other in executing certain tasks, which allows each partner to bring forth its best traits, in order to provide public services and execute projects in the financially most effective way (PWC, 2004: 9; Kernaghan, 1993; Carr, 1998; Osborne, 2000).

The object of a partnership agreement is the private sector organisation's (either partial or total) obligation and right to renovate, construct, preserve and/or manage an institution or system that provides a public service. As a rule, the public sector retains the right of ownership based on these agreements, although the representative of the private sector invests capital into the formation and development of the specific property. These agreements are also defined as cooperative institutional arrangements between private and public sector representatives (Greve and Hodge, 2005: 1). Public-private partnerships not only place great importance on the private sector's financial capital investments but also incorporate the utilisation of private sector knowledge and skills, which results in greater effectiveness during the lifecycle of the projects. The core of a public-private partnership involves more than just the provision of services or the construction and financing of infrastructure (UNECE, 1999).

The roles of the public and private sector vary within the framework of different forms of partnership (Larkin, 1994). Contracting out is differentiated from partnerships primarily by the private partner's high-risk investment and its access to new revenues or a new service provision without additional expenditures (NCPPP, 2007). In South American and Far East countries, it is common to contracting out the right to construct and operate large infrastructure projects (Hall, 1998; Li and Akintoye, 2003: 3).

PPPs are treated as all of the following: a new form of governance, a direction in the New Public Management model, a form of infrastructure investment, as contracting out (see Greve and Hodge, 2005: 1), as an instrument of governance or just "a word game" (Teisman and Klijn, 2002).

However, the majority of researchers have arrived at the common position that PPPs are an organizational and financial agreement, whereby the joining of the public and private sector provides a new value dimension to the interaction between independent processes (Widdus, 2001; Pongsiri, 2002; Nijkamp, *et al.,* 2002). Due to its dynamic nature, many different PPP models exist, and the given form of cooperation is constantly developing (Hall 1998). It is also important to understand that every partnership project takes place in a definite economic, political and judicial area, which sets different frameworks and foundations for the project.

A PPP's organizational aspects are characterised by a financial dimension (the financial connections between the partners) and organizational dimension (the closeness of the relationship between the partners) (Greve and

Hodge, 2005: 5). Teisman and Klijn (2002) find that the partners must search for the best solutions together in the name of effective results and the organisation of work and not accept the usual domination by the public sector. The financial interests of the countries that utilise PPPs result from the need to increase infrastructural investments, to use resource more effectively and to receive commercial benefit from public sector properties (Ministry of Finance, 2006: 7).

PPPs allow for the creation of international joint enterprises and other forms of cooperation with private sector companies, and thereby, to obtain high-level specialised knowledge, experiences, know-how and global experiences related to similar projects. PPPs have also proven that this form is potentially a way to distribute various economic, social and environmental benefits (Perrot and Chatelus, 2000; UNECE, 1999).

Preconditions for a successful PPP are that its nature be defined, its basic principles be clarified, along with the possibilities of the judicial and administrative area that is necessary for its implementation. Although, cooperation between the public and private sector provides many advantages in regard to economic aspects and the quality of services, this must not become a universal method for the transference of administrative tasks that are inconvenient of the state or for finding supplementary financers to compensate for budgetary deficits (STAT/04/18). As a point of departure, it is necessary to assess the maximum possible benefit for both parties from the resources being spent. This is what differentiates PPPs from traditional procurement agreements (COM (2003) 283).

Partnership always takes place between specific partners, which include state or local government units, legal persons governed by public law as well as physical and legal persons governed by private law. When choosing a partner, the nature of the project, the risk, financial investments and time-related outlook should be taken into account.

The above also provides an answer to the question posed in the subtitle – Do the forms of public and private sector cooperation compete or do they complement each other? The implementation of different forms of cooperation is an individual process, and their implementation depends on the developmental needs and opportunities of a specific society. At the same time, the changes that impact inter-sector cooperation must be understood, since only by working together can the sectors achieve the objectives that they cannot achieve by acting alone. PPPs, the implementation and development of which present one of the most important challenges for both sectors, have a special place among the forms of public and private sector cooperation (van Ham and Koopenjan, 2002).

Implementation of Public and Private Sector Cooperation in Estonia - Problems, Quests and Solutions

PPP implementation practices can be found in many countries and in various fields of activity and their numbers have increased from year to year (Bovaird, 2004). The European Commission (2004) notes that public and private sector cooperation in the development and operation of environmental and transport-related infrastructure has increased in recent years. In 1997-1999, the United Kingdom's PFI[2] (Private Finance Initiative) agreements totalled more than £8 billion, and half of the local authority bodies used partnership as a means of establishing supplier relations (HM Treasury, 2000). In addition, 9% of local authority bodies plan to do so in the near future (Birch, 2001). It is not possible to determine the volume of PPPs in Estonia, due to the lack of a relevant statistical database (Lõhmus, 2008). However, as a result of the research conducted by the authors, one can state that the practice to date is limited in volume, uncertain and

[2] A PPP mechanism

occurs in a judicial area that is not ordered for carrying out such projects.

In Estonia, few PPP projects have been carried out based on the conditions described above. Compared to many European projects, they have been much smaller in scope with regard to both money and time. A few proposals have been made for the construction of the Saaremaa Bridge and the Tallinn-Tartu highway, but in the name of risk management and due to expensive and long-term consulting services, they have not been discussed seriously (Karniol, 2008).

There are a few examples of Estonian PPP projects: the Viimsi Rural Municipality, in cooperation with the Merko Ehitus construction company and SEB bank, has built a Viimsi schoolhouse; a 30-year concession agreement has been concluded with Tallinn Heating; the City of Tallinn, in cooperation with ELL Real Estate, has built a bus terminal under the Viru Shopping Centre. The construction of Tallinn's municipal housing, the renovation of Tallinn's schools and the construction of the Viimsi Elementary School can also be treated as PPP projects. However, in the latter case, the rural municipality decided to reacquire the completed schoolhouse and its lot.

Based on the above examples, one can state that in Estonia PPP projects have been primarily implemented at the local government level, of which the largest are the school renovations and municipal housing construction carried out by Tallinn. At the national government level, the Ministry of Defence has shown interest in PPP projects, and has investigated the means to utilise the given form of cooperation. In the administrative area of the Ministry of Defence, the opportunity to utilise PPPs is seen to exist primarily in projects related to the development of infrastructure, where there are large-scale procurements and a long utilisation period.

As a pilot project, the Ministry of Defence is in the last stages of a housing project at the Baltic Defence College, which, as far as the authors know, is the first infrastructural PPP project in Estonia at the national government level. Essentially this is a DBFM (design-build-finance-maintain) -type PPP project, although the size of the project is smaller (about 10 m EUR) than similar European PPP projects.

The Development Plan for Military Defence for 2009-2018 (Regulation no. 21 of the Government of the Republic dated 22 January 2009) provides for the development of the Jägala campus during the next decade, and the execution of this project as a PPP is being considered.

Although, the nature of the PPP concept puts the focus on the involvement of the private sector, based on the acquisition of added value (greater competence, financial effectiveness), and only thereafter, on the opportunities for involving financial resources. In Estonia the PPP projects are primarily carried out in order to built/renovate objects without having to recognise the transactions on one's balance sheet (off-balance sheet transaction). Therefore, PPPs have been implemented in Estonia primarily as a financing scheme (Ministry of Finance, 2006).

An analysis of the projects to date reveals many differences in their implementation. Thus, the contracts for the City of Tallinn PPP projects specified that the majority of risks were to be borne by the private sector, which is why the PPP projects are not recognised on Tallinn's balance sheet and the annual costs for PPP projects are recognised in the city's operating expenses (TLES, 2008-2011). Pursuant the restrictions on debt obligations and repayments specified by the Rural Municipality and City Budgets Act (RT I 1995, 17, 234; RT I 2009, 35, 232), local government units have been forced to search for new possibilities to raise capital. The City of Tallinn has used PPPs as one such possibility.

On 11 February 2008, the Accounting Board issued its Directive no. 17 entitled "Concession Agreements for Services" (RTL 2008, 20, 294), which would enter into force on 1 January 2009, and would also apply retroactively to all valid PPP projects. The purpose of the directive was to force local governments to recognise PPP projects on their balance sheets. The City of Tallinn appealed to the Supreme Court, and the Court ruled (15 December 2008 ruling 3-4-1-14-08) that the obligation to compile annual reports in accordance with the accounting principles presented in the general accounting rules, and based on the Accounting Act and the requirements for annual reports specified in the Accounting Board directives infringed on the financial autonomy of local governments, and the rights of local governments to independently decide and organise issues related to local life.

City of Tallinn's PPP Projects

The PPP projects for school renovation/reconstruction were motivated by the fact that the majority of the schoolhouses in Tallinn were built during the Soviet era, and repair cycles had been postponed for many years due to the lack of financial resources. At the state level, a solution to the problem was initiated through a program entitled "Put Our Schools in Order" organised by the Riigi Kinnisvara AS. The fact that Riigi Kinnisvara AS is part of the government sector, and the expenditures made by it affect the budgetary position of the government sector, forced the City of Tallinn to turn towards the private sector. In 2006, the City of Tallinn passed a resolution to renovate ten schoolhouses as PPP projects, followed by four more in 2008. At the same time, Tallinn renovated other schoolhouses through traditional construction procurements.

The City of Tallinn decided to use the PPP form in order to speed up the school renovations, under conditions of limited financial and administrative resources, and to transfer a reasonable portion of the risks related to the investment to the private sector, as well as improve the quality of the corresponding service (Jäppinen, 2007). Based on the assessment of the concerned parties, the implementation of PPP enabled the financial effectiveness of Tallinn's investment to be increased and allowed the schools to focus on what's most important – the better organisation of studies *(ibid).*

Tallinn also constructed municipal housing as a PPP project. The housing construction program entitled "5,000 Residences for Tallinn"; the principal objective of which was to solve the housing problems of involuntary tenants and improve the living conditions of young and large families, as well as essential city officials. To fulfil the given objectives, the city concluded cooperation agreements with private partners, who were to build one new residential area each (Loopealse and Raadiku) (Tallinn City Council, 2002).

The Tallinn City Government employed a DBFM scheme to carry out these projects. A competition with preliminary negotiations was organised in order to constitute a right of *superficies,* with the obligation to renovate/construct schools/buildings and lease/rent them to the city for thirty years. In addition to the renovation/construction work, the private partner was assigned the obligation to finance the work and carry out the long-term management and maintenance of the schools/buildings. Throughout the entire contractual period, the schools/buildings must be maintained in a condition appropriate to their assigned purpose, and during this time, the private partner must undertake to execute the necessary repair work and guarantee the maintenance of the building. The shortcoming of this scheme is that the process is not as transparent or controllable as the organisation of a public procurement, which is regulated by law. Pursuant to the valid legal order, the procedure for constituting rights of *superficies* is established by the local governments themselves. Thereupon, the given scheme, which was used by the City of Tallinn, lacks transparency, and created a negative image for this form of PPP.

The difference between the renovation of schools and the construction of municipal housing is that, in the case of the school PPP project, the schools are rented to the city, which also pays the utility bills. In the case of the municipal housing PPP, the city rents the living premises from the private partner, and then rents them to tenants who pay about a ¼ of the rental price, while the city pays ¾ of the rental price. The tenants also pay the utility bills.

Initially, the Tallinn Education Department and the Tallinn Housing Department have both satisfied been with the results of the PPP projects, and have said that the city itself lacks the funds to deal with one or another problem to the required extent (Kreek, 2008; Pärtelpoeg, 2008). It was also noted that utilising a PPP scheme has enabled the problems related to the schools and municipal housing to be resolved effectively and quickly, compared to the usual step-by-step renovation/construction work that would require many more years to achieve the same result *(ibid).*

Are there any Prospects for the Implementation of PPPs in Estonia?

There is great interest in PPP projects on the part of local government units (Roos, 2007; Müürsepp, 2007; Allika, 2007), while the number and volume of PPP projects that would create new fixed assets are small. Although, from the viewpoint of economic policy, it is currently right to restrict borrowing by local governments, as a balancing factor, it is necessary to find alternative ways to increase their revenue base. The slowdown of wage increases that has occurred during the recession has also slowed the growth of the revenue base of local government, through the receipt of individual income taxes. A potential solution could be the utilisation of EU funding, but the state would have to come to the aid of the local governments in the utilisation of those funds, because the level of self-financing amounts is unattainable for most local governments (Innopolis, 2005). One way to enliven the economy is to involve private sector money, and PPP projects are a good example of this.

Based on a survey that was conducted during the course of research, we can state that local investors are interested in investing in PPP projects due to their guaranteed yield, their long-term nature, and the guarantees and stability provided by the projects (Kruuda, 2008; Parelo, 2008; Ross, 2008; Sõõrumaa, 2008). Local investors see more opportunities to implement PPPs in various fields of activity than have been used thus far, for instance: education, health care, social institutions and care homes, hospitals, family medical centres, infrastructural and tourist objects (Kruuda, 2008; Parelo, 2008; Ross, 2008; Sõõrumaa, 2008).

The main difficulty in implementing PPP projects in Estonia is the inadequacy of the regulations regarding accounting procedures (Karu, 2008; Kreek, 2008; Kruuda, 2008; Parelo, 2008; Pärtelpoeg, 2008; Ross, 2008; Sõõrumaa, 2008). In Estonia, PPP projects have been motivated by the opportunity to delete them from the balance sheet, although the main emphasis should be on the added value that results from the involvement of the private sector (Ministry of Finance, 2006: 28). The same trend can be encountered elsewhere in the world (Hodge, 2004), and this is considered to be one of the advantages of PPPs (Bloomfield, 2006), although, one should recognise the limits and consider their benefits for local development (Johnson and Mikesell, 1994).

In addition, both the public sector and the general public are not well informed about the nature of PPP projects, and the opportunities that they provide at both the national and local levels of government, and therefore, PPP projects are treated as shady deals (Kruuda, 2008). Just as important is the political will and courage of the public sector to involve the private sector to a greater extent in making and managing state investments (Ross, 2008).

When developing PPPs, it is very important that the society understand what PPPs involve (Kruuda, 2008). This could help to prevent negative attitudes on the part of the public and the media *(ibid)*. It is possible that the bad reputation of PPPs is the reason why the country's political leadership wishes to distance itself from the subject.

Estonia is lacking the experience necessary to carry out complicated and large-scale PPP projects. Therefore, possible analyses, decision-making and planning is done in cooperation with companies that provide business consultancy services, such as auditing and consulting firms, law offices, etc. According to P. Lillestik, the public understanding of PPPs could be significantly strengthened by the creation of a competence centre – the importance of an independent competence centre was also stressed by J. Roos and U. Allika.

The Ministry of Finance, which manages the given field of activity, takes the position that, based on practical needs, it is not sensible to create a PPP unit at the national level as a centre for technical expertise (see in more detail Murumägi, 2007). PPP projects are usually complicated and large in scope, and in these cases PPP experts should be contracted from outside the public sector i.e. from consulting firms (often from outside of Estonia, since there is a lack of experience in the country regarding the implementation of large-scale projects). The Ministry's position is that the creation of PPP units should be weighed in the future together with local government associations, Enterprise Estonia and interested ministries (foremost the Ministry of Economic Affairs and Communication, Ministry of the Interior, and Ministry of Justice).

As a result of initial analysis, the Ministry of Finance has taken the position that Estonia does not need to work out an independent legal framework to regulate the PPP sphere. It has expressed the opinion that the implementation of various forms of public and private sector partnership is possible within the framework of established law, which can be supplemented in the course of expanding the fields of application and the scale of the corresponding projects. According to the Ministry of Finance, the best solution is to regulate PPP projects with guidelines and the Law of Financial Management in Local Government (Karniol, 2008).

At the same time, it should be recognised the implementation of PPP projects is regulated by numerous laws with a universal scope of application e.g. the Public Procurement Act, Administrative Cooperation Act, Local Government Organisation Act, State Liability Act and the implementing provisions thereupon. Due to the dispersal of the legal sources regulating partnerships, they need to be systematically interpreted and implemented. However, based on interviews, the people in local government often lack the necessary knowledge and skills.

Legislation is amended for various reasons and at different times, which complicates their uniform implementation and interpretation, reducing legal clarity and security for the partners in the resolution of problems.
Therefore, the authors' believe that the Ministry of Finance is taking a narrow agency-centred view and is not considering the rapidly changing needs of society along with the opportunities provided by the implementation of PPP projects.

How to Move Forward?

The implementation of PPP projects in Estonia is still a relatively new and developing field of activity. The first order of business is to work out an implementation model for PPPs that is based on a well-ordered theoretical foundation, the critically evaluated experiences of other countries and Estonia's needs and judicial area. The given model must deal with the various stages of the PPP process, provide instructions for choosing partners, organising tenders, conducting preliminary negotiations, and cooperating with private sector partners after the contract is concluded.

The task of managing the development of this implementation model must be assigned to the Ministry of Finance during the next few years. This would be a precondition for increasing the number of projects that are to be implemented. Scholars and experts from the universities that deal with the corresponding field of activity should be involved in the development of the model, as well as leading local auditors and law firms that possess practical experience. The Ministry of Finance needs to process and analyse the collected material, and propose the suitable models. If necessary, the Ministry should also make recommendations for the amendment of valid legislation, in order to guarantee the coordination of the work at the national level.

In addition, clear standards need to be created for the recognition of the PPP projects in accounting, and not always be recognised on public sector balance sheets as is required by the various laws and regulations.

In order to stimulate the implementation of PPPs, a generally positive political attitude for involving the private sector must be assured. As mentioned above, the legal regulation must be ordered and the public must be informed about PPPs based on examples of successful projects in Europe. Also competence, based on the experiences of neighbouring and other European countries, should be involved in order to avoid having to start from nothing (Kruuda, 2008). Consulting services are very expensive and large amounts of resources will be spent, primarily by the public sector, which must draw up the contracts (Karniol, 2008). Therefore, it would be essential to create a competence centre. The national government as well as the local governments should have use of the same information centre. The corresponding structure should either be attached to the Ministry of Finance or the Ministry of Economic Affairs, which would determine its competence and fields of activity.

What can we Learn from our Neighbouring Countries?

In Latvia the government has approved a PPP Policy Framework Document and has also approved a PPP Plan of Action for 2006-2009. The projects in Latvia are regulated by public procurement, concession and PPP legislation. The projects that are planned include the Riga ring road, and construction of a new Via Baltica route outside of Riga.

In Lithuania, the most active implementer of PPP projects is the City of Vilnius. However, here too, there are no projects that are entirely PPPs (as described in the European Commission's guidelines). The project components have been partially implemented: long-term contracts with heating and water companies, for parking and a water park. In Lithuania, the legislation regulating PPP projects includes the public procurement law, and the law regulating concessions (there is no separate PPP law). At the same time the procedures for competitive dialogue are included in the concession legislation. In Estonia, concessions are not sufficiently regulated (e.g. step-in rights, the transfer of a significant share to the private partner, delegation of the contract, and other questions related to the long-term nature of the contracts).

Conclusions and Proposals

Cooperation with the private sector may occur in various forms, starting with traditional privatisation and contracting out, and ending with partnerships that are currently gaining popularity in many countries. However, this always assumes a thorough analysis of the tasks, functions and operating environments of the partnership by the public sector organisation.

The objective of the cooperation is to reduce the tasks of the public sector and to increase their economic efficiency and effectiveness, by changing the public partner from an implementer to a regulator and supervisor. Projects must be dealt with systematically based on the existing boundaries, opportunities, risks, restrictions and prospects of their utilisation. Cooperation always occurs in the political, economic and judicial area, which determines the conditions and possibilities for implementation. The legal environment must guarantee the compilation of a contract that ensures honest competition, transparency and takes the interest of the public sector unit into consideration.

Based on an assessment of the regulative capability and scope of the Estonian legal system, a decision has been made not to draw up framework legislation to regulate partnership projects (VV, 2006). Therefore, when carrying out partnership projects, it must be taken into account that the necessary legal foundations are disseminated throughout various laws and other legislation, and require systematic interpretation upon their implementation since the scope of the given laws is universal, and the relevant standards are also implemented in the regulations of other relationships. This situation complicates the improvement and amendment of laws, which function based on various conceptual foundations and in different temporal dimensions. The universality of the established legislation's scope of application also makes it more difficult to consider the peculiarities related to the establishment of businesses by local government units when implementing partnerships, when assembling financial mechanisms for partnership projects, when announcing procurements, and also in the course of possible bankruptcy proceedings of the businesses as a result of partnership projects. A well-ordered partnership concept in the public and private sector concept would allow for a systematic approach to the development and improvement of the legal environment that regulates partnership.

According to Directive no. 17 of the Accounting Board, assets and expenses related to PPPs are to be recognised on the balance sheet of the corresponding public sector unit, which causes a sharp increase in the loan burden of the respective local government units that may conflict with the Rural Municipality and City Budgets Act. However, considering the need for guaranteeing the development of local life and regional balance, the most promising field for the implementation of public and private sector cooperation projects is the local government level. Although, based on the corresponding ruling by the Supreme Court, this instruction is only a recommendation, such a contradictory regulation points to a disputable political and judicial area and does not create a sense of security for possible cooperation partners.

From the viewpoint of economic policy, the restriction on borrowing by local governments is currently justified, but it is also necessary to find alternative ways to increase the revenue base of local governments. The slowdown of wage increases has also slowed the growth of the revenues bases of local governments through the receipt of individual income tax. A potential solution could be, for instance, the utilisation of EU funding, but here the state should come to the aid of the local governments, since the level of the self-financing is unattainable for most local governments. Public and private sector cooperation is still primarily an economic policy measure, which enables high-quality public services to be provided effectively and economically while at the same time enlivening the economy.

At the level of the EU and its member states, it has been understood that inter-sector partnership as a form of cooperation requires institutional changes, based not only on the changes in liability, whereby the public sector unit becomes the manager and supervisor of the process instead of the provider, but also in order to develop the PPP concept and make the utilisation of PPP projects more effective (EC, 2003a: 50). At the same time, the needs and opportunities provided by public and private sector cooperation under Estonian conditions have not been sufficiently analysed; the current implementation practices have not been synthesised and combined into an integrated economic, social and legal environment.

Cooperation with the private sector may not always be the best solution for the provision of services. Therefore, the public sector unit must carefully analyse all the accompanying factors and possible problems. If the assets of the participants and the possible positive impact of the cooperation are maximised, cooperation projects, and especially partnerships, can promote the expansion of public services and the improvement of their quality. However, answers need to be provided for the following questions for each potential cooperation project: should the help of persons governed by private law be used, and what would be the resulting benefits?

We lack the experience to carry out complicated and large-scale partnership projects. Therefore, possible analyses, decision-making and planning needs to be carried out in cooperation with companies that provide business advisory services such as auditors and consulting firms, law offices, etc. The lack of local competence may also be the result of political short-sightedness – on the one hand, the state wishes to have strong local government units that would be able to fulfil the assignments placed on them by the law, while at the same time, they do not take their different levels of development and extremely limited possibilities into account, in the development of its policies and the judicial area.

In order to successfully carry out partnership projects a theoretically and methodically well-ordered foundation and well-considered implementation must exist. The partnership units and guidelines established in the US, Canada, South Africa, United Kingdom, Ireland and many other countries help to give meaning to functional and organizational regulations in the actual legal environment, as well as describing the requirements, preconditions, stages and implementation practices for the projects. The primary precondition for successful cooperation is the existence of mutual interests at the national and local government, as well as private sector levels. The necessary elements include political support and stability, the existence of a well-regulated legal environment, the developmental initiative of the potential participants, and the definition of the benchmarks related to the partnership project.

Local investors are interested in cooperation projects, and in Tallinn they see many opportunities for the implementation of PPPs in various fields of activity. However, a favourable environment and sufficient competences are lacking. In order to stimulate PPPs a general political climate that promotes the involvement of the private sector has to be guaranteed. As mentioned above, legal regulations must be well-ordered, and the general public educated by highlighting examples of successful PPPs elsewhere in Europe. A competence based on the experiences of neighbouring countries and other European countries should be employed.

The prevailing economic situation is one where the expenditures of the government sector are limited, and there is a wish to limit the borrowing possibilities of local government, that inhibits the ability of the local governments to provide public services. PPPs have enabled the public sector to provide public services (renovate schools and build municipal housing) under changing economic conditions, guaranteeing stability in the satisfaction of public sector needs and the provision of services. It would be sensible to continue to utilise this potential in the future and to find new possibilities (e.g. though EU funding) to implement projects. PPPs have resulted in a higher quality together with added value in Tallinn's projects and a noteworthy saving through efficiency. Although the projects in Tallinn have achieved effectiveness and added value, this is an exception rather than the rule. The efficiency and added value achieved by the given projects provide confirmation of the benefits achieved from PPP and their potential, if the existence of a favourable and well-ordered environment in Estonia is confirmed. However, the environment for the implementation of PPPs is not favourable in Estonia. Although, the few PPP projects that have been implemented have the possibility to lead to an increase in efficiency and quality in the provision of public services.

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