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Is it time for a new business model?

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TITLE

Is it time for a new business model? From a wealth maximisation model towards a human development model.

ABSTRACT

This paper argues that the current model of business focuses on economic objectives, such as ‘sustainable profit growth’, to the detriment of social and environmental objectives. Under this model it is difficult for businesses to address concerns of global social equity, increasing the wellbeing or welfare of humanity and environmental sustainability. Drawing on Anand and Sen’s (2000) ‘human development’ framework, this paper explores a business model based on environmental, social and economic sustainability principles and practices. The paper draws on theory and data from a work-in-progress research project and identifies key challenges in moving to a ‘human development’ model of business. Areas for further research are suggested to move towards a more sustainable and equitable society.

INTRODUCTION

There is considerable academic and public debate about whether global society is better off from the continued pursuit of economic growth and wealth maximisation. The question 'is life getting better or worse' was referred to in a recent newspaper article as "the defining question of our times" (Eckersley, 2004). The most recent report from the International Labour Organisation (2003) revealed that the gap between the world's poorest 20 per cent and the richest 20 per cent has more than doubled between 1960 and 1999. Half the world lives on less than US\$2 a day and more than one billion people struggle on \$1 a day or less.

Traditionally, the measure of prosperity and national progress is an economic measure: gross national product (GNP) or gross domestic product (GDP). Nations strive for economic growth and to increase GNP per capita, believing that this reflects increased wellbeing or welfare. GNP has been accused of ignoring the costs of social decline, environmental deterioration and environmental damage control and repair. There is substantial evidence that an increase in GNP does not necessarily reflect an increase in welfare, wellbeing or indeed happiness (Douthwaite, 1999; Hamilton, 2003). Alternative measures, such as the genuine progress indicator (GPI), were developed to provide a national balance sheet that includes both the costs and the benefits of economic growth, recognising environmental and social cost. As such, the GPI is considered a better indicator of progress in terms of social equity, wellbeing and welfare. While GDP has steadily increased in the UK and USA from 1950 to 1995, since the late 1970s the GPI has steadily declined. In Australia, from 1996 to 2000, GDP per capita rose 13.4% while GPI rose by only 3.6% (Hamilton & Denniss, 2000).

Concern about a decline in the 'social fabric', the growing inequality and a perceived loss of 'community' is increasing in our society (Jacobs, 1996). Measures of social wellbeing which go

beyond income alone appear to confirm the feeling that the quality of life is getting worse rather than better (Ayres, 1998; Hamilton, 2003; Hamilton & Mail, 2003; The Harwood Group, 1995).

Additionally, it is claimed that our current economic model with its patterns of economic growth has resulted in environmental degradation. Jacobs (1996) believes that these environmental and social problems are not symptoms of the model's failure, but of its success. The problems are endemic and the better the model performs, the worse the problems will become. Jacobs further points out that the problems are related and cannot be dealt with separately and incrementally - they require fundamental changes in the patterns of economic and social development and in our understanding of what constitutes progress.

His conclusion is that change is imperative, not just in the patterns of economic development, but also in the model itself. The model is ultimately self-defeating and any alternative model must start by addressing the unquestioned pursuit of economic growth.

The debate about the efficacy of our economic model is reflected at the firm level. For many years the role of business in society has been debated. Is the primary role of corporations to maximise profits and the wealth of its shareholders (in line with the economic growth focus of the current economic model) or should firms give more equal attention to social, environmental and economic responsibilities? While there is progress on corporations becoming more socially and environmentally responsible, the current business model is primarily focussed on the financial responsibilities of a firm, specifically 'sustainable profit growth'. In this paper I argue that while the current economic growth paradigm and wealth maximisation business model prevails, profit maximisation will always take precedence over issues of social and environmental issues and that it is indeed time for a new business model.

This paper examines the issues around moving from a ‘wealth maximisation’ model to a ‘human development’ model from the perspective of sustainability – a model that focuses on the development of the community, society and humanity within a context of environmental sustainability. The paper discusses the role of business in society in the context of the corporate social responsibility (CSR) and sustainability literature and critiques the dominant economic-focused business model. The paper draws on a current research project to start to piece together what a human development oriented business model might look like and identifies future research that would be beneficial to the ongoing development of alternative business models.

HUMAN DEVELOPMENT VERSUS WEALTH MAXIMISATION

According to Anand and Sen (2000) the integration of human progress and environmental conservation is one of the major challenges faced by our global society. The ‘human development’ approach advocated by Anand and Sen focuses on the development of human capability across all races, classes, genders and nationalities. It encompasses social justice and social equity in the contemporary world. Anand and Sen broaden the focus of human development from the current generation (intra-generational equity) to accommodate the claims of the future generations (inter-generational equity) and the urgency of environmental protection. Anand and Sen trace society’s focus on wealth maximisation, to the detriment of equitable human development, to mainstream economics’ preoccupation over the centuries with "commodity production, opulence and financial success" and to leading economists, businessmen and bureaucrats concentrating on overall material success rather than on the deprivation and development of human lives. They view the focus on contemporary society’s measure of progress, GNP, as “a continuation – perhaps even an intensification – of the old opulence-oriented approach” (p.2031).

The current business model has evolved from this wealth maximisation tradition and hence reflects the economic focus of our society and socio-economic structures. While GNP is used to measure national progress and prosperity, financial indicators such as revenue, profitability and shareholder value are used to measure company performance, progress and success – profit is seen as an ‘end’ in itself rather than a ‘means’ to an end.

However, if our objective is human development, then it follows that a wealth maximisation business model is not the most appropriate business model to achieve the objectives and outcomes of human development – businesses would have different priorities and approaches to doing business. Profit would be seen as an enabling ‘means’ to achieve an ‘end’ in line with human development. I propose that fundamental transformation of the current business model is required to support human development – from a model that is based on neoclassical economic concepts of wealth maximisation to a model that embraces social equity and environmental and social sustainability.

THE NEOCLASSICAL ECONOMIC MODEL

The current business model is based on neoclassical economic theory that focuses on maximising the wealth of the firm and its owners. Neoclassical economic theory stems from Adam Smith’s work in the 1700s. In his book, the *Wealth of Nations* written in 1776 (1937), Smith discusses the relationship between owners and consumers in the marketplace. He argues that pursuing one’s private interests need not conflict with, and indeed may contribute to, the public good. Under optimal competitive conditions the market, which Smith calls the ‘invisible hand’, actually increases the public good by improving the economic wellbeing even of those not directly competing in the marketplace, despite the primarily self-interested intentions of those participating in economic affairs.

Adam Smith's concept of the invisible hand has been interpreted as "the free market created out of perfect competition among self-interested individual economic actors, a market that functions as an independent arbitrator and stabiliser for the economy" (Werhane, 1991, p.102). This interpretation is based on the belief that the *Wealth of Nations* establishes a powerful economic justification for the pursuit of individual self-interest. In neoclassical economic theory, the goal of Smith's 'economic man' is to maximise the wealth of the firm, based on contractual duties to owners. This model assumes that the only duties the firm has to 'external others' are financial - these duties are owed to the owners, which in the case of modern corporations are shareholders (Brenner and Cochran 1991, cited in Key, 1999). Key contends that while the economic model has continued to be the measuring stick for any 'theory of the firm', or theory of the marketplace, the motivating values for behaviour in the market place have been ignored and replaced by a focus on the end criterion, profit.

While the social mandate for business may have changed, as represented by the increase in use of language such as sustainable development, corporate social responsibility (CSR) and stakeholders, the conceptualisation of business as more than a profit-maximising system has not permeated the business model itself (Stormer, 2003). Profit is still treated as an 'end', rather than a means to an end; that is, the purpose of business is expressed in terms of maximising profits rather than in facilitating the exchange of goods and services to contribute to the wellbeing of all of society's members and a more equitable society. People are treated as a means to achieving this profit and therefore can be 'cut' if profit targets are not met.

In contrast, the human development approach does not see human beings as merely a means of production and material prosperity: human beings are seen as persons, not as economic activity.

As Anand and Sen (2000) point out, while human beings are also “superb means of production”, that is “not the most momentous fact about us” (p.2040).

In contrast to the neoclassical economic model a human development model would promote the development of human capability and social equity alongside economic development and environmental stewardship - it would promote ecological and human sustainability alongside economic sustainability.

SUSTAINABILITY

According to Anand and Sen (2000), the idea of sustainable development arose from concerns relating to the overexploitation of natural and environmental resources. Early discussions stressed the limits to economic activity imposed by the physical environment and the issue of inter-generational equity. The classic definition of sustainable development comes from the World Commission on Environment and Development report (1990 p.87): “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”. More recently the issues of social or human sustainability (social equity and increasing social welfare or wellbeing for all of humanity) and intra-generational equity have been debated. In their definition of sustainability Dunphy *et al* (2000) distinguish between ecological and human sustainability: ecological sustainability is about redesigning organisations to contribute to sustainable economic development and the protection and renewal of the biosphere; human sustainability entails building human capability and skills for sustainable high-level organisational performance and for community and societal wellbeing.

According to Griffiths and Petrick (2001), traditional architectures will not support the adoption of the changes in business practices necessary to achieve human and ecological sustainability. The path towards sustainability will result from the generation of new models of organisations

that support social relationships ('social capital') and the natural world ('natural capital') (Dunphy, Griffiths, & Benn, 2003).

TOWARDS A 'HUMAN DEVELOPMENT' MODEL

What would a business model look like that supported a human development framework? To start to understand this, I examine the experiences of the Australian subsidiary of a global manufacturing company that is implementing a model that puts sustainability at the heart of the business.

Interface Inc. is a recognized leader in the worldwide interiors market, offering floorcoverings and fabrics. The company is the world's largest manufacturer of modular carpet. It also manufactures broadloom carpet and is a producer of interior fabrics and upholstery products.

Interface was chosen as a case study as it is considered one of the leading companies in restructuring its business model around sustainability (Dunphy et al., 2000; Elkington, 2001; Rowledge, Barton, & Brady, 1999). This is reflected in its mission: "Interface will become the first name in commercial and institutional interiors worldwide through its commitment to people, process, product, place and profits. We will strive to create an organization wherein all people are accorded unconditional respect and dignity; one that allows each person to continuously learn and develop. We will focus on product (which includes service) through constant emphasis on process quality and engineering, which we will combine with careful attention to our customers' needs so as always to deliver superior value to our customers, thereby maximizing all stakeholders' satisfaction. We will honor the places where we do business by endeavoring to become the first name in industrial ecology, a corporation that cherishes nature and restores the environment. Interface will lead by example and validate by results, including profits, leaving

the world a better place than when we began, and we will be restorative through the power of our influence in the world." (<http://www.interfaceinc.com/goals/mission.html>)

The primary method of data collection was face-to-face in-depth interviews with staff at the Australian subsidiary of Interface. Seven interviews were conducted from the major functional areas in Interface Australia (operations, sales and marketing, finance and IT, services and management). Secondary data included annual reports (1999-2002), press releases, sustainability reports, the website, books and articles.

Whilst a human development model cannot be extrapolated from a single case study, Interface's experience highlights the challenges of implementing a model focused on sustainability in a neoclassical business world that values wealth maximisation over human development. The success and longevity of a company that puts sustainability at the heart of the business is influenced by a number of factors, both internal and external to the company. Achieving its sustainability goals requires working closely with all its stakeholders to gain their trust and support for Interface's initiatives, continuous investment in technology and processes, and, in the long-term, a shift in the socio-economic infrastructure to support sustainability (such as the financial markets, key performance indicators, government policy and internalisation of all costs). The findings of the Interface case study and their implications for a human development model are discussed below.

Interface Case Study - Implications for a Human Development Model

Companies often equate sustainability with higher costs, and hence lower profits. Since sustainability projects are often treated as an expense rather than an investment, they can be 'cut' if profitability targets are not met. This trade-off mentality limits the investment in sustainability projects.

On the other hand, profitability is important to the survival of a company. Companies cannot pursue social and environmental sustainability to the detriment of financial sustainability. Staying in business is a fundamental tenet to being an environmentally and socially sustainable company and influencing the long-term sustainability debate.

A company cannot have a long-term impact on environmental and social sustainability if it goes out of business. Profits are important to invest in further sustainability initiatives. The question is, how much profit do you invest in sustainability and how much do you distribute to your shareholders as dividends? At this stage, differences in the prevailing neoclassical business model (NBM) and Interface's model appear. The NBM treats profit as an end goal, driven along by expectations of the financial markets/analysts and shareholders. Interface treats profit as a means to its end goal of sustainability. Profits enable ongoing investment in sustainability. Sustainability initiatives, in turn, can reduce costs and improve profitability (for example, by a reduction in waste), providing further funding for sustainability projects. The NBM has a short-term focus, typically quarterly, while Interface focuses on longer-term returns (where 'returns' are not just financial returns but also encompass the impact of environmental and social sustainability initiatives). A short-term financial focus generally encourages companies to approve projects that have short-term financial impacts - such as typical cost-cutting measures of downsizing and retrenchment - and discourages companies from investing in projects with longer-term paybacks, such as sustainability. The investment required in new technology and processes to support a shift to sustainability typically does not have a short-term (quarterly) return. Progress is often made in steps, sometimes leaps, not typically by incremental continuous improvement. Interface has demonstrated that cost savings can result from investments in sustainability as well as better quality products with longer lives (reduction in waste has resulted

in cost savings of US\$270 million from 1997-2002). As one of the staff commented: “sustainability, product improvement and financial bottom line improvement can all work together”. However, the payback for an investment may typically be longer than what the NBM tolerates. Spikes followed by plateaus replace continuous, quarter-on-quarter profit growth. This implies that while profitability and sustainability can be mutually enforcing, relentless quarterly profit growth would not be the goal of a human development model of business (HDM).

The neoclassical economic model is criticised for its inability to deal with externalities (unpriced benefits or costs such as pollution, the impact of global warming, erosion and depletion of natural resources). Typically companies do not incorporate externalities except through duties imposed by laws and regulations in force or by making provisions for the potential risk of a dispute. According to Ruffin and Anderson (1996), externalities constitute the main exception to the rule that Adam Smith's ‘invisible hand’ will efficiently allocate resources. One solution to internalising these costs is to apply a Pigovian tax. In theory, if prices to the consumer do not measure full cost, then those prices are adjusted by means of adding a tax (positive or negative, depending if it is a cost or benefit) in the amount that results in full cost and the market's efficiency is restored. Decisions by consumers and producers would then be made in the full light of full-cost prices (Daly, Cobb, & Cobb, 1994). Pigou theorised that when the producer was forced to bear full costs, it would have incentives to reduce its negative impact, thus lowering those costs. As Paul Hawken explains, “The purpose of integrating cost into pricing is not to provide a toll road for polluters, but a pathway to innovation. The incentive to lower costs is the same one that presently operates in all businesses, but in this case the producer's most efficient means to lower them is not externalising these costs onto society, but implementing better design” (p83).

In the short-term, internalising all costs by way of some sort of tax would reduce profits and hence the financial value of the company. This implies that short-term financial indicators (like profit) may not be the most appropriate way to measure a company's performance under a HDM where environmental and social impact costs are internalised. Quarterly financial reporting may not be the most appropriate means of reporting company performance and progress. Sustainability and human development indicators, reflecting progress on economic, social and environmental sustainability, need to be developed to measure the performance and progress of companies. Further research is required in this area.

To support a move towards environmental sustainability, restructuring of industrial economies is required along the lines of: using less environmentally damaging materials (such as renewable energy); improving the productivity of inputs through new technology; and shifting the composition of output from 'goods' to 'services' (Jacobs, 1997a). Interface's model specifically addresses these areas, with varying degrees of success. Interface approaches sustainability from seven 'fronts'. The seven fronts of sustainability cover: eliminating the concept of waste, not just incrementally reducing it; eliminating molecular waste emissions - waste streams that have negative or toxic effects on natural systems; reducing the energy demands of processes while substituting nonrenewable sources with sustainable ones; redesigning processes and products into cyclical materials flow; exploring methods to reduce the transportation of molecules (products and people) in favour of moving information. This includes plant location, logistics, information technology, video conferencing, e-mail, and telecommuting; creating a community within and around the organisation that understands the functioning of natural systems and its impact on them ('sensitivity hookup'); and, redesigning commerce to focus on the delivery of

service and value instead of material - encouraging external organizations to create policies and market incentives promoting sustainable practices.

Investment in technology and new processes has resulted in a reduction in the raw material used and a reduction in waste and emissions while ongoing research into renewable feedstock aims to replace the petro-chemical raw material with a fully bio-degradable raw material (such as corn husks). The technological and process improvements have resulted in Interface not only reducing the environmental impact of its economic activity but also in significant cost savings, hence contributing to its environmental and economic sustainability.

A carpet leasing service was introduced as an alternative to customers buying the product. Under the leasing service, Interface is responsible for taking back the carpet at the end of its life and recycling or repurposing it – the carpet does not go into landfill. The shift from selling products to services has not been so successful to date in Australia, as customers have not embraced this idea. The implication is that more than just technology and new processes are required for companies to move to this type of model. It requires a ‘value-shift’ in the client base such that clients value sustainability and eventually demand that their suppliers provide these types of products and services. As Interface identified, internal and external education and communication about sustainability is important so that its stakeholders understand these issues and can make decisions based on more than financial imperatives.

Until recently, environmental sustainability had been Interface’s key focus and a critical missing factor was a genuine focus on people – social sustainability. In 2000 sustainability was reinforced as the core value of the company and the social dimension of sustainability was put at the core of its vision, alongside environmental sustainability and economic profitability: “caring for human capital and natural capital (Earth) as much as we have traditionally cared for financial

capital will give social equity and environmental stewardship their rightful places alongside economic progress, and move society to reinvent the means for achieving economic progress itself” (Anderson, 1998). According to Interface, social sustainability is about improving relationships between Interface and its stakeholders over time and improving the quality of life for its stakeholders: employees (associates), customers, suppliers, local and global communities and shareholders. Whilst Interface has initiated a number of projects with its local communities, it has made less progress on social sustainability than environmental sustainability. Additional case studies on companies that have focussed on social sustainability (including social equity) are required to further explore the implications for a HDM.

Moving to a sustainable world and a human development business model requires fundamental changes to the socio-economic system (Dunphy et al., 2000; Elkington, 1997; Hawken, 1993; Jacobs, 1993). This is ratified by Interface’s experiences. As Interface staff expressed, becoming a restorative company requires more than just the business model to change – it requires supporting infrastructure to recognise and move towards sustainability. The interviewed staff pointed to several areas that require transformation: financial markets value companies and measure their performance by financial indicators only – they ignore progress on sustainability; financial markets have a short-term financial focus compared to the long-term focus of sustainability; the treatment of externalities (internalising costs) and the role of government policy in creating a ‘level playing field’; educating external stakeholders such as customers, suppliers and the general community about sustainability (including schools); and investment in technology and major infrastructure for supporting sustainability (such as renewable energy facilities, sustainable transportation options and recycling facilities available to all companies).

SUMMARY

This paper examined some of the issues in moving from a model based on a wealth maximisation paradigm to a model that draws on a human development framework (encompassing social and environmental sustainability). The paper described one company's experiences in implementing a business model that puts sustainability at the heart of the model while operating in a neoclassical business world that values profit maximisation over sustainability. Interface's model is a step along the way towards Anand and Sen's (2000) human development ideal and can contribute to understanding how to get there.

A 'mainstream move' by businesses to adopt more sustainable business models is unlikely to occur in the absence of the whole of society moving towards sustainability. As Michael Jacobs (1997b) points out, sustainability requires long-term structural change in economy and society: changes not just in the demands for a wide variety of goods and services, but in technologies, infrastructures and lifestyles.

Further research is necessary to explore the structural changes required to move to a sustainable society such as the transformation of the legal, regulatory, political, financial, economic and educational frameworks. While Anand and Sen (2000) believe that government policies, such as Pigovian taxes, subsidies and regulation are required to bring about sustainability, others claim that business is the economic engine of the future and therefore must not only be part of the solution but must lead the way towards sustainability (Hart, 1997).

It seems clear that government policy and business need to acknowledge the increasing social inequity and environmental deterioration/destruction and that fundamental changes to the business model are required to address these issues. Further research into companies leading the

way towards sustainability, such as Interface, can assist the process of transforming the business model to support sustainability and to move towards a human development model.

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