

## **Appropriate consideration of value added law as a precondition of social responsibility**

Assoc. Prof. Živko Bergant, PhD  
College for Accounting  
Institute for Management Accounting  
Ljubljana, Slovenia  
[zivko.bergant@vsr.net](mailto:zivko.bergant@vsr.net)

### **Abstract**

The author offers the thesis that surplus value added is a prerequisite for the sustainable development of enterprises. Accordingly, he designs a model that captures the creation and distribution of value added. Social responsibility is based on an appropriate sharing of value added. For this purpose, a new category is specifically defined, namely surplus value added. The author substantiates the connection of value added with social responsibility through the disclosure of the value added law that operates in every community of people who have a common goal. Its consideration means sharing the value added among stakeholders in accordance with their contributions to creation of the value added. The division of value added, which does not take this into account, increases the entropy of the system.

Keywords: social responsibility, sustainable development, value added, value added law, surplus value added.

## **Ustrezno upoštevanje zakona dodane vrednosti kot pogoj družbene odgovornosti**

### **Povzetek**

Avtor postavi tezo, da je presežna dodana vrednost temeljni pogoj za trajnostni razvoj podjetij. Temu ustrezno oblikuje model, ki zajema ustvarjanje in delitev dodane vrednosti. Družbena odgovornost temelji na ustrezni delitvi dodane vrednosti. Z ta namen je posebej opredeljena nova kategorija, in sicer presežna dodana vrednost. Avtor utemeljuje povezanost dodane vrednosti z družbeno odgovornostjo tako, da razkrije zakon dodane vrednosti, ki deluje v vsaki združbi ljudi, ki imajo skupni cilj. Njegovo upoštevanje pomeni delitev dodane vrednosti med deležnike skladno z njihovimi prispevki k ustvarjanju dodane vrednosti. Delitev dodane vrednosti, ki tega ne upošteva, povečuje entropijo sistema.

Ključne besede: družbena odgovornost, trajnostni razvoj, dodana vrednost, zakon dodane vrednosti, presežna dodana vrednost.



## **1 Introduction**

The claim that social responsibility is a prerequisite for sustainable development is logical at first glance, but it must be recognized that there is not complete consensus among the professionals in this respect. For example, Friedman argues that "corporate social responsibility is an increase in profit" and points out that social spending can have a negative impact on investors. Others, on the contrary, argue that investors will reward a company that is socially oriented, with investments despite the risk of lower returns (both of which are found in Milne and Chan 1999, summarized by Van Staden, 2000, 9). Similarly, an empirical study is established to justify value added as one of the key indicators of sustainable development (Oshika, Saka, 2015, 14). Also, Donleavy notes the positive impact of value added on the company's market value (Donleavy, 2015, 325 and Zeng, 2013).

The profession therefore largely recognizes the importance of social responsibility, but in my estimation it has not yet found a definitive evidence to support such claims. Empirically such a proof is impossible, since we are talking about a distant future, and the study of the direction of the movements in the past is insufficiently convincing, especially for those people who have short-term interests.

Therefore, in this paper, we will take another path. As a starting point, we will form a management model with the goal of value added as a condition of sustainable development, and then develop the justification for this assumption.

## **2 Value added management model**

The starting point of the model in Figure 1 is the assumption that sustainable development is the fundamental objective of the community because it is consistent with the concept of its social responsibility, since it can take maximum account of stakeholders' interests.

Figure 1 defines two basic orientations (goals) of management:

- The volume of gross value added (creating *GAV*),
- The structure of gross value added (guiding *GAV*).

Gross value added also includes depreciation.

Here we should immediately emphasize that with the value added (*AV*) in Figure 1 we mean its widest definition, i.e. also with non-linearly expressed achievements or returns (expanded value added).

In assessing the appropriateness of decisions in these areas from a sustainable point of view, we can help with the principles and recommendations of *ISO* standards on quality of business in these areas, which is also indicated in Figure 1.

The quality area of course, includes also current business, aimed at increasing revenue and managing costs, that is the quality of business effects, which is evident from Figure 1. This area is generally covered with *ISO* standards.

Figure 1 shows the framework model of management based on value added and its relationship to risk management. The emphasis on value added is important because the modern profession still clings to traditional value added as the starting point of a comprehensive model of sustainable development (e.g. Chousa, Castro, Schaltegger et al., 2006, 93).



Figure 1 shows the important dimension of management, that is, the ethics of operation, which is directly related to the social responsibility of the community.

The basic content and dimension of management is risk management, which is also shown.

Management affects the accounting volume of gross value added (GVA) through the revenues and costs of material and services and the reduction of processes that do not bear the value added or reduce it. This is the field of traditional enterprise economics, which includes in particular:

- Market assessment and planning of basic activities,
- Acquisition and management of procurement costs,
- The creation of products and services and their costs,
- Selling and managing sales costs,
- Managing indirect and general costs,
- The use of operational and financial leverage.

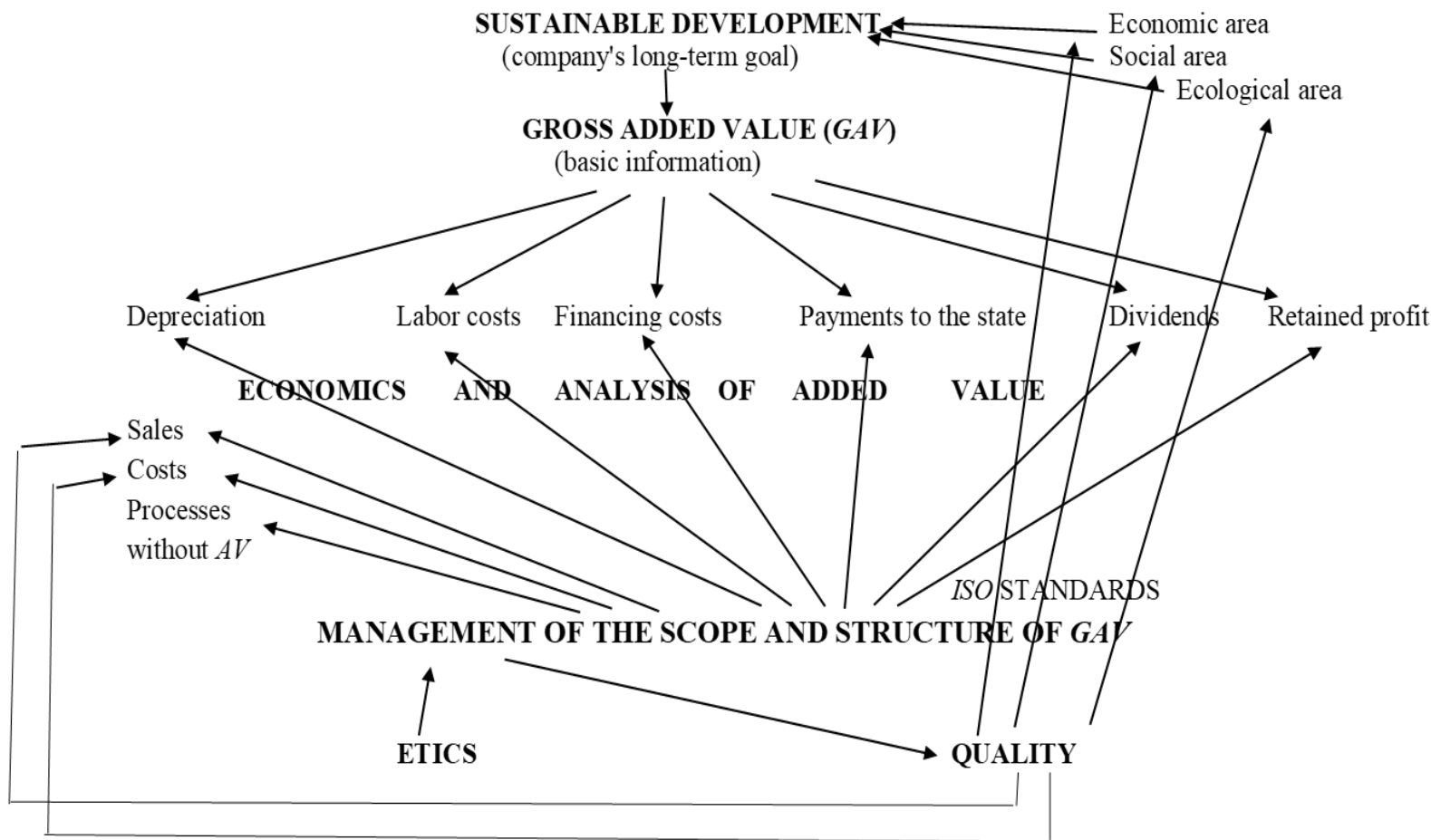
In the accounting structure of GVA, management affects decisions, in particular regarding:

1. The policy of depreciation of intangible and tangible fixed assets,
2. The cost of labor, the development of employees, the maintenance and increase of intellectual capital,
3. The cost of financing and ensuring the solvency of the group,
4. Planning and optimizing tax burdens,
5. Designing and implementing a dividend policy,
6. Retained earnings.

The listed areas of business decisions which are shown in Figure 1, reflect the weight and responsibility of the management. Their consequences are directly reflected in the value added, and thus in the possibilities of sustainable development of the organization.



Figure 1: Value added management model



Of course, the presented model, which emphasizes value added as a precondition for achieving sustainable development, remains only one of the possible models, if we do not justify its starting point, which is the value added. Justifying will be offered in the next chapter.

### **3 Value added law**

We will briefly summarize the following starting points:

1. The basic goal or the desire of human being is its existence, which arises from the instinct aimed at self-preservation, and from it, the human basic needs and interests arise;
2. This is the reason why a person wants to ensure adequate security; for this purpose he or she creates various organizational systems; the component of the operation of each organizational system is the risk;
3. Without the risk management, there is no value added, which (as a reserve for ensuring security) expresses the common interest of all elements of the organizational system (people);
4. Combining people into organizational system, each person which operates within it, contributes to a common goal;
5. Where the value added (in the broadest sense) is not (or no longer) the common goal of the participants, it a system is in the process of decay;
6. Participants shall manage the risk in accordance with their respective interests within the limits of the objective possibilities and within the limits set by the environment;
7. In the case of legal or contractual regulation of the mutual relations between the participants in the organizational system, there will inevitably be a re-allocation of risk;
8. The fundamental interest of all participants in the organizational system is the acquisition of a share in the value added proportionally to their contribution to managing the risk;
9. If the interests of the participants are adequately met (and the narrow and short-term interests of individuals do not prevail), the organizational system is in balance;
10. The occurrence of a disproportion between the accepted risk and the yield attributable to an individual participant results in the creation of entropy forces or increases their power in the system;
11. The strengthening of entropy forces threatens the sustainable development of the organizational system;
12. The basic conditions for the effective participation of participants are the appropriate level of knowledge or competence and appropriate information system with an appropriate communication process involved;
13. The inclusion of a greater number of actors in the functioning of the system (in particular in terms of decision-making) can be dysfunctional and inefficient; therefore, solutions are needed in order to use appropriate methods for their creative cooperation and effective monitoring system;
14. Participants in the organizational system are responsible for ensuring the existence and sustainable development of the system, if its sustainable orientation is accepted jointly.

On the basis of the above starting points, we define *the general law of creating and guiding value added* (hereinafter: value added law), which includes two aspects:

1. Value added is the net outcome of the organizational system in managing the risk inherent to the system and belonging to risk holders in proportion to their contribution to the functioning of the organizational system (the aspect of creating value added);



2. The disproportionately high or disproportionately low participation of individual risk carriers in the value added (according to their work contribution) increases the entropy of the organizational system and threatens the realization of its sustainable development (the aspect of value-added guidance).

The law is general because of its validation in all socio-economic systems (past, present and future), which are oriented towards sustainable development. The law has various forms of its presence in different economic and political environments and in different types of organization (relations between people) of associations.

First of all, two important categories of the law need to be clarified: the net outcome and the contribution to the functioning of the organizational system.

The *net* outcome within this law is understood in the broadest sense, from qualitative, accounting and broad value estimates to the satisfaction of the participants. Estimating the net result is therefore dependent on the type of organizational system (e.g. household, society, institution, non-profit organization, economic community, municipality, state, humanity as a whole). The important word is *net* because it means the difference between the total outcome (recognized by users or market certified) and the estimated costs of operating the system (including labor costs, consumption of natural assets or the cost of their replacement, and environmental conservation costs associated with the total outcome). This means that the estimated labor cost in substance does not represent a newly created value. The same applies to the opportunity cost of capital.

If the estimated labor cost and the opportunity cost of capital are subtracted from the value added, we get a new category, named *the surplus value added* that is the subject of the division among stakeholders.

The contribution to the functioning of the organizational system also should be understood in the broadest sense, i.e. in all possible forms (e.g. materialized work, such as real and monetary inputs, knowledge, and of course current physical and intellectual work, including guarantees and opportunity costs or losses of individual participants). Mulej similarly speaks about "the effort for the lowest entropy" (Mulej *et al.*, 2000, 269).

The next important notion in the dictum of the value added law is entropy, which is originally an otherwise physical category, but in social or organizational systems it is defined as a "general, eternal and natural process that expresses the natural tendency of everything existing to decay" (Mulej *et al.*, 2000, 260).

On the basis of the value added law we understand the entropy of organizational systems mainly as a result of the imbalance between participants' contributions and their participation in value added. The imbalance is devastating because it works against cooperation and mutual trust, which is necessary in the context of interdependence (Judt, 2011, 57 and 80).

The value added law operates regardless of the wishes or activities of the participants and regardless of the normative organization of the organizational system or its environment. It is, therefore, totally independent of the human will that created the organizational system.



It is important that we are aware that the balance of the organizational system (or minimal entropy) at the same time also means the state of its minimum stability (Kukoleča, 1972, 168), as the balance is constantly collapsing. Therefore, there is a constant need for risk management and the effect of "invested effort" is reflected in the value added that is confirmed on the market or by users in the broadest sense.

The value added law in its own way shows the shortcomings of various company theories, including contract theory, which treats relationships between stakeholders as a kind of contractual relationship.

The value added law has two important, complementary characteristics, namely its:

- Creation, because the labor (contribution in the form of investments or personal cooperation) in risk management in the framework of efforts to get outcome from the functioning of the system is the only source of the value added;
- Guiding, which is the fundamental principle of distribution of value added.

We can notice the similarity with the value added statement, which indicates the estimate achieved and the distributed value added as well. Both aspects are complementary and only together form a whole.

At the same time, there is a significant difference between the value added and the value added statement. In the value added statement, a calculation estimate of value added derives from its (as well as calculation) definition, while the law explains the right source of value added, i.e. socially recognized work (in the widest sense) in risk management.

The fact that the labor (the contribution to risk management) is fundamental for the participation in value added also shows a deep ethical principle, which is not a presumption of the value added law, but because of its functioning, it is an essential component of all human creation. In this regard, it should be noted that today there is often the opinion that the distribution is essentially the only matter of morality (e.g. Judt, 2011, 65), but the equilibrium in the distribution is overlooked as an integral part of the value added law.

This means that the constant desire to increase the reserve by its own, is not necessarily unethical, since in its own way it reflects the desire of man for self-preservation. However, it becomes unethical as soon as the participation of an individual in value added exceeds the proportion of his or her contribution to the risk management. Then, the desire to increase the reserve turns into greed, which is unacceptable not only from the ethical point of view, but also from the point of view of social responsibility and sustainable development. The desire of the individual after the increase of the reserve is therefore the driving force of development, and his or her greed is the driving force of decay.

#### **4 Conclusion**

It follows from the above that adequate sharing of surplus value added does not only mean the enforcement of some ethical norms, but is a fundamental precondition for the sustainable development of companies and society in general. The only alternative is increasing dissatisfaction and the growth of entropy of all organizational systems.





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