World Journal of Social Sciences
Vol. 4. No. 3. October 2014 Issue. Pp. 12 – 23

Introducing the Double Bottom Line (DBL) measurement approach for the Social Business model and the Economic Valued Added (EVA) theory as a measure of financial sustainability

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In the body of existing knowledge, there exist limited studies encompassing the milieu of social business due to the novelty of the social business model. This academic paper addresses a significant gap in the existing literature by criticizing the triple bottom line measurement approach proposed by previous scholars and establish its limitations in addressing social and environmental problems in the social business paradigm. The authors establish the double bottom line (DBL) performance measurement approach that social businesses should pursue in the form of social and environmental value. In consequence, this paper projects how the social business model, through the utilization of the double bottom line performance measurement approach, can play a more superior role to the triple bottom line in bringing about social and environmental change. In addition, the authors of this paper propose the economic value added (EVA) theory as an appropriate tool to evaluate sustainability in a social business to facilitate social and environmental transformation for the present and future generations. Consequently, a flow chart is presented which illustrates how DBL can be implemented and sustainability can be measured through the implementation of the EVA theory. Finally, this paper outlines its limitations which can influence future research studies for researchers to pursue based on the conceptualization of the DBL.

Keywords: Social Business, Double Bottom Line, Triple Bottom line, Social value, Environmental value, Sustainability, Economic Value Added

1. Introduction

For profit maximization firms, the triple bottom line approach encapsulates three important dimensions of business performance: social, environmental, and economic value (Elkington, 1997; Sridhar, 2012; Sridhar, 2011a). The economic performance signifies the success organizations have in the marketplace and within the company which eventually is reflected through profit and sound financial decisions in greater shareholder's monetary value. Additionally, environmental performance reflects how a business complies with government regulations and mandates as far as protection of the environment is concerned. Finally, social performance shows how a company addresses some social problems through various social activities. In conventional, profit maximizing businesses, economic value maximization for the shareholders remains the chief motive, followed by the economic and social values as a support to the primary bottom line. In other words, the parameters of the triple bottom line approach are not mutually exclusive. Corporate managers pursue social and environmental causes in order to enhance corporate image

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which in turn enhances economic performance of the firm (chang, 2011). For instance, scholars such as Burke and Longsdon (1996) and Husted and Allen (2007) have established positive results indicating that social activities that a firm pursues not only produces social value, but captures economic value in return as well. Furthermore, researchers such as Judge and Douglas (1998) and Klassen and McLaughlin (1996) have empirically established affirmative relationships between proactive environmental strategies and economic performance.

However, in the social business paradigm, the economic bottom line does not exist. This is because a social business is a non profit, non dividend company addressing social and environmental problems and does not strive to achieve any economic gain (Yunus, 2010). The social business incorporates maximization of social and environmental values as its primary business operation rather than playing a supporting role. It is a business model built around a social and environmental goal and tries to create profit out of it only to sustain itself. Thus the question arises, can the traditional triple bottom line performance measure be applied when it comes to the Social Business Model? To answer this question one thing should be kept in mind that traditional triple bottom line keeps the economic value as the primary, and social and environmental values are the secondary bottom lines. Then the answer is no. Hence, the authors of this paper propose a mutually exclusive approach towards the establishment of the double bottom line (DBL) performance measurement in a social business encapsulating social and environmental values only; whereby the motive of the social business will be solely focused on addressing social and environmental problems and not improving financial performance. Due to the novelty of the social business paradigm, there exists limited research work revealing the value a social business generates. Hence, this academic paper addresses a gap in the literature by establishing social and environmental value as the dual bottom lines in social business.

Additionally, one of the key ingredients of the social business paradigm is its sustainable characteristic which signifies that a social business attempts to prevent losses just like any conventional company (Yunus, 2009). Here lies the significant difference between a non-profit business and a social business. Furthermore, the investors receive their invested money only, without any dividends whereby the rest of the accumulated profit is reinvested for expansion of the social business (Yunus, 2010). Other than being the chief motive for the business, profit maximization, or rather profit making, becomes the supporting role of a social business needed only to sustain a viable operation. A comprehensive study conducted by Hammond, Kramer, Katz, Tran, and Walker (2007) which was co-published by the International Finance Corporation and the World Resource Institute, quantified the spending phenomenon of the world's poor people. According to their study, there exists an estimated 4 billion people at the bottom of the pyramid with incomes below $3,000 per annum in local purchasing power. Hence, from a social business perspective, in order to address the needs of this mass segment, products/services should be priced low to facilitate affordability. Meeting low price requirements while not compromising quality calls for significant operational measures to maintain sustainability, as a social business must generate enough income to cover all its costs (Yunus, 2010). In other words, running a social business venture in a sustainable manner is a challenging task.

Sustainability has evolved as a mainstay of corporate strategy and is increasingly being applied by many organizations across the globe (Hall, Daneke, and Lenox, 2010). The Brundtland Commission defined sustainability as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (WCED, 1987, p. 43). Hence, sustainability is crucial for a social business to

achieve its sole purpose of addressing social and environmental problems. However, just like a conventional business, a social business cannot be sustainable if it makes losses. Hence, this study incorporates the economic value added (EVA) measure of financial sustainability as an appropriate appraisal to apprehend sustainability in a social business. There exist limited scholarly articles in the milieu of social business revealing financial measurement approaches to determine sustainability. Hence, this academic paper addresses a gap in the literature by proposing the EVA theory as an appropriate measurement tool to evaluate sustainability in a social business.

In the following sections of the paper the authors will highlight some of the previous studies on how the triple bottom line approach was implemented in conventional business models and address the limitations of such approach in the social business paradigm. Furthermore the double bottom line (DBL) approach will be explained and proposed as the more appropriate measure to be applied in social business with the EVA measure as the supporting tool for sustainability.

2. Literature Review

John Elkington's hunt to find a sustainability measure during the mid-1990s went beyond the traditional measures of profits, return on investment, and shareholder value to include environmental and social dimensions. This accounting framework was called the triple bottom line (TBL) (Slaper & Hall, 2011). The notion of the triple bottom line accounting is being increasingly utilized in NGO, investing, consulting, and management circles. The significant reason behind the application of the triple bottom line paradigm is because an organization's success or health should be measured not by the traditional economic bottom line only, but also by its social and environmental performance (Godfrey and Manikas, 2009; Elkington, 1997). This is because; firms have a variety of obligations towards its stakeholders to behave responsibly. Scholars such as Norman and Macdonald (2004) have reinforced that a firm cannot be successful in the long run if it continuously disregards the interest of its stakeholders. Hence, the conceptualization of the triple bottom line accounting reflects the organisation's fulfilment of obligations towards its community, investors, customers, employees, suppliers, marketing intermediaries, and other stakeholders. Furthermore, such endeavours should be measured, calculated, audited, and reported – just like the economic performance of a company has been for more than a century.

Hence, if organizations believe that social responsibility and ethical business practices are significant parameters of management and corporate governance, then firms should welcome the utilization of the triple bottom line accounting framework to facilitate transparency of the firm's economic, social, and environmental performance for its stakeholders (Norman and Macdonald, 2004). Institutions such as *Global Reporting Initiative* and *AccountAbility* have embraced the utilization of the triple bottom line accounting framework and have promoted the theory for use in the corporate world. In consequence, various firms such as *Shell, British Telecom, AT&T,* and *Dow Chemical* have utilized the framework and have even used the triple bottom line terminology in their annual reports, press releases and other documents (Norman and Macdonald, 2004). Furthermore, various accounting firms are also rendering services to corporations to measure, audit, and report not only a firm's economic performance, but also the two additional bottom lines embraced in the triple bottom line accounting framework. This section of the paper will reflect on the significance of each parameter of the triple bottom line accounting framework. Furthermore, the authors of this paper will also discuss how

each element of the framework can be measured while also revealing any challenges and gaps in the implementation of this framework to the Social Business concept.

2.1 Economic Bottom Line

When Elkington (1997) first discussed about the triple bottom line approach, he explained the economic bottom-line as the economic value added to the business. Through the passage of time, this idea has been explained in different forms in variety of writings and researches (Norman and MacDonald, 2004; Godfrey and Manikas, 2012; Sherman, 2012). As a result, the economic bottom-line has been conceptualized as simply the profit of the company (Elkington, 1997). Profit is the accounting term that is calculated as the difference between revenues and expenses (Weygandt, Kimmel & Kieso, 2012). Cascade Engineering, an American company in the renewable energy sector, prides in their implementation of triple bottom line and issues annual triple bottom line reports (Cascade Engineering, 2009). Slaper & Hall (2011) took this company's report of 2009 as a case and showed that their measure of economic value was that of the tax expenses they paid. Taking this into consideration they further suggested the use of revenue size, asset size or operational efficiencies as measures of economic value added to the business. All these factors are directly involved in increasing the accounting profit of the business which eventually adds on to the shareholder's value. However it does not reflect whether these measures can be used as a measure of financial sustainability.

For any conventional business, the primary goal is to maximize the shareholder's value (Brigham & Houston, 2009). This can only happen if profitability is increased. Thus successful managers' focus is to ensure continuous growth of accounting profit. However, accounting profit is limited in trying to find the total economic value that is added in the business. This is because, the expenses to calculate profit does not include the cost of the capital invested in the business. Acquiring capital to run a business is costly as firms need to pay interest on borrowed capital and required rate of return on share capital (Ross, Westerfield, Jaffe, 2010). Accounting profit calculation does not subtract these costs and hence it does not reflect the true residual economic value added to the business. Hence, the aforementioned discussion reflects a gap in the measurement of the economic bottom line. The authors of this paper believe that in order to measure the pure economic profit that an organization generates – the cost of capital should also be subtracted from the revenues along with the fixed and variable costs that a firm incurs. As a result, a positive outcome of such a measurement will reflect the true financial self-sustainability of a company and will reinforce the organization's capacity to pursue internal financing to expand its business operations. On the contrary, a negative result during the measurement of the economic bottom line will indicate that the company has not reached break even yet. As long as the measurement of the economic bottom line is not positive, a company cannot achieve financial self-sustainability.

2.2 Social and Environmental Bottom Line

The triple bottom line accounting framework embraces two additional bottom lines: social and environmental value. Social values are the good work that goes above and beyond what traditional business delivers to eradicate any social problem (Auerswald, 2009). Environmental values start with the compliance of government rules to maintain a sustainable environment. The authors of this paper examined a wide range of scholarly papers to comprehend and uncover the reasons behind organizations implementing, measuring, and reporting the additional bottom lines. In consequence, the authors of this

paper present three significant reasons behind the aforementioned question. Firstly, implementing and measuring social and environmental performance helps address various social and environmental problems (Norman and Macdonald, 2004). In consequence, firms with a better social and environmental performance tend to be more profitable in the long run. Secondly, firms have an obligation to maximize their social and environmental bottom line (Norman and Macdonald, 2004). As a result, an accurate measurement is necessary to judge the performance of an organization as far as social and environment impacts are concerned. This in turn will facilitate comprehension as to whether firms have successfully fulfilled their obligations. And lastly, firms are obligated to be transparent to their stakeholders and disclose information about how well it performs in these two additional bottom lines (Norman and Macdonald, 2004).

There are various accounting measures through which these additional bottom lines can be measured. Some notable standard setting measures and bodies include SEAAR (social and ethical accounting, auditing and reporting), GRI (global Reporting Initiative), SA 8000 from Social Accountability International, the AA 1000 from AccountAbility, as well as categories of various ISO standards. The significant purpose of these standard measures is to discover indicators of social and environmental performance while also revealing methodological grounds to measure, audit, and report social and environmental performance. However, the existing literature does not reveal a generalized agreed-upon measurement scale to evaluate all the three bottom lines in an integrated manner (Slaper & Hall, 2011). This in turn, creates a barrier for investors to effectively evaluate and comprehend the impact of their investment on the society, the environment and also their own financial earnings. Furthermore, the eradication of various social and environmental problems cannot be achieved overnight. It requires long term planning and investment. However, the chief motive of an investor is to generate a healthy return on investment in terms of monetary value not social or environmental value.

The above review of literature shows how conventional business incorporates the triple bottom line approach in their performance measurement system. While trying to implement this measure in the social business model it was found to be quite limited conceptually. Conventional business considers the social and environmental value exclusive of the core business operation, while the economic value addition is considered a result of the primary business operation. To achieve the goal of profit maximization, the most popular way is to cut out unnecessary expenses. As a result, any spending in social and environmental activities used to be minimized. It was because of this reason that the triple bottom line was introduced to keep the importance of social and environmental values as an equal to economic values.

However, such is not the case for social business. For a social business, socio-environmental investments are not separate from regular business operations. The businesses do not need to set aside capital for it. Since the core operation of the business itself is a social act, it cannot make profits unless social and environmental values increase. Hence, achieving socio-environmental goals is a prerequisite to generating profit. Furthermore, social businesses do not pay any dividends from their profits (Yunus, 2010). Instead, profits are reinvested back into to business (Yunus, 2009). This means the investors or shareholders are only entitled to their initial startup capital (Yunus, 2010). Thus maximizing shareholders' wealth is not a goal for social businesses unlike conventional businesses (Yunus, Moingeon, and Ortega, 2010). Trying to keep the social and environmental values as equal to the economic value, as suggested through triple bottom line, is not conceptually possible for social business. By definition, the social and

environmental values should be given higher priority for a social business to sustain. To address this gap, this paper proposed a new model, the double bottom line (DBL) and considers Economic Value Added (EVA) as a measure of economic sustainability for social business.

3. Proposed Model: The Double Bottom Line (DBL) Approach and Economic Value Added (EVA) Theory as a Measure of Sustainability

This academic paper conceptualises social and environmental value as the Double Bottom Line (DBL) performance measurement approach in a social business. Subsequently, the authors of this paper reveal the significance of social and environmental value.

3.1 Social Value

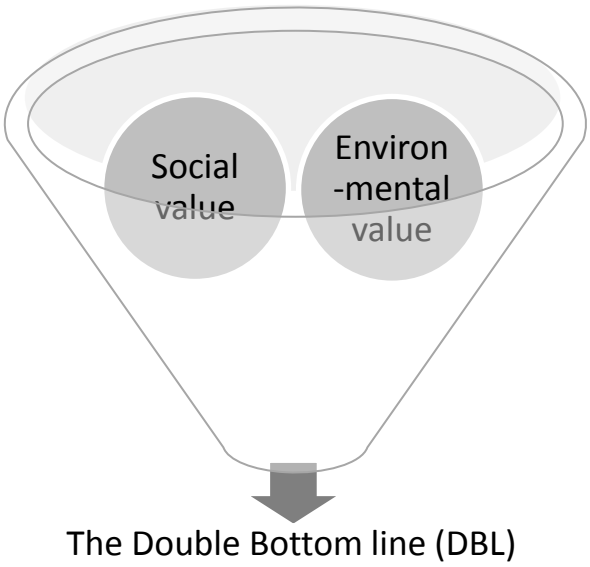
A social business improves the economic and social conditions of the people who are under privileged (Yunus, Moingeon, and Ortega, 2010). The social business model is designed to facilitate the inclusion of the under privileged living under the poverty line to equally participate in the market based economic activities (Rahman and Hussain, 2012). According to the pyramid of economic prosperity, most profit maximization firms do not produce goods and services for the people belonging to the bottom of the pyramid (Prahald and Hammond, 2002). This is because these people possess limited or no disposable income and purchasing power (Prahald and Hammond, 2002). However, a social business targets the people belonging to the bottom of the pyramid and addresses their needs (Rahman and Hussain, 2012). As a result, a social business creates *social value* by engaging in activities that facilitates societal improvement by means of eliminating obstacles that thwart social development (Austin, Stevenson, and Wei-Skillern, 2006; Smith and Stevens, 2010). Hence, by cultivating social value, a social business fulfils the basic and long standing needs of the bottom of the pyramid (Certo and Miller, 2008). Such needs include health, food, water, education, and etcetera that produce social wealth (Drayton, 2002).

3.2 Environmental Value

In the milieu of business management, scholars have given significant importance on the conceptualization and implementation of environmental management practices (e.g. Aragon-correa and Sharma, 2003; Banerjee, 2002; Vachon and Klassen, 2008). The various stakeholders of a business such as the government and the customers want the business practices of the organization to be environmentally conscious (Vidal-Salazar, Cordon-Pozo, and Ferron-Vilchez, 2012). As a result, organizations are re-engineering and modifying their business processes in order to create environmental value. However, from the perspective of a social business, the authors of this paper define environmental value as *"the ability of a social business to have a zero impact on the environment and also partake in sustainable business driven deeds that addresses environmental problems"*. One of the core values of a social business is addressing environmental problems. Thus, if through its operational activities and business processes, a social business by itself harms the environment, then its key core value is not justified. Hence, a social business should strive to have a zero impact on the environment in order to consider itself a social business. Additionally, a social business can commence with the aim to address a specific environmental problem in the quest to shield environmental

degradation. Figure 1 below illustrates the DBL performance measurement approach in a social business

Figure 1: The double bottom line performance measure approach in a social business



3.3 Economic Value Added (EVA): A Measure of Economic Sustainability

The proposed new DBL model does not take into consideration the economic bottom line, but it does not completely disregard the economic consequences of social business either. Like any other business, social business also needs to be profitable. However, a social business does not need to focus on maximizing profit. All it needs to focus on is whether the profits generated cover the initial startup capital and the costs associated in acquiring the capital (Yunus 2010). Anything above that is an opportunity for expansion. Since the accounting profit does not consider the cost of acquiring capital in its calculations, it does not represent the true economic value added. Thus a social business cannot focus on accounting profit to maintain their goal of sustainability. They require a new measure. In consequence, this research paper addresses a gap in the literature by proposing the economic value added (EVA) theory as a significant tool to measure sustainability in a social business.

How much economic value a business adds is basically a measure of performance of the business. Some of the popular measures of business performances besides accounting profit are return on equity, return on asset, tobin's q, price-earnings, earnings per share etc. Although these are chosen for their simplicity, but they hardly fulfill the measurement criteria of social businesses. All the above mentioned ratios measure performance mostly in terms of the value added to the shareholders rather than whether the economic values add to business sustainability. This paper, therefore, ignores the more conventional performance measures and selects Economic Value Added (EVA) as the appropriate measure of sustainability for social businesses.

EVA was introduced by Stern Stewart & Co. which is a financial consultancy firm. As defined by Stern Stewart, EVA is the difference between a company's net operating profit after tax and its cost of capital of both equity and debt (Stern Stewart, 1993). The

consultancy firm introduced this theory as a performance measure of any business based on how much value is added through the operation of the firm. The advantage this measure has over accounting profit is that it not only considers the operational expenses but also the cost of obtaining the capital. Net Operation Profit After Tax (NOPAT) covers all the expenses including the expenses incurred for the social and environmental value addition. And by subtracting the cost of capital, the interest expense and required rate of return of investors are also taken into account. Thus the true residual value created through business operation is reflected in it. In the box below details of how any conventional business calculates EVA is shown in table 1:

Table 1: Economic Value Added (EVA) Calculation explained

EVA = NOPAT – (WACC * Total Capital)

Explanation of the terms used:

1. Net Operating Profit After Tax (NOPAT) = EBIT(1-T)
    a. Earnings Before Interest and Tax expense (EBIT) = Operating Profit
    b. Tax rate (T) = Rate of tax on profit set by the government
2. Weighted Average Cost of Capital (WACC) = [Loan capital*i(1-T)] + [Equity Capital*r]
    a. Interest (i) = the rate of interest on loan set by bank or creditors
    b. Rate of return (r) = required rate of return on the capital invested by the investors usually found out using a popular financial model called CAPM.
3. Total Capital = (Loan capital or principal) + (Equity Capital or investors' contribution)

Despite its popularity as a performance measure, EVA has been criticized by some researchers. Chen and Dodd (1997) although agrees to the fact that EVA provides relatively more information than the traditional measures of accounting profit, they still believe that EVA cannot completely replace the accounting profit measures. One reason, as found out through their empirical study, is that EVA is not very strongly associated with stockholder's return. Garvey & Milbourne (2001) went even further and suggested that accounting profit has a more positive correlation with stock's value than EVA. But one must take into account the fact that these criticisms are not important for the social business model. Both the papers criticized EVA in the terms of shareholders' value maximization. Since social business' goal is not associated with shareholder value thus such criticisms are invalid.

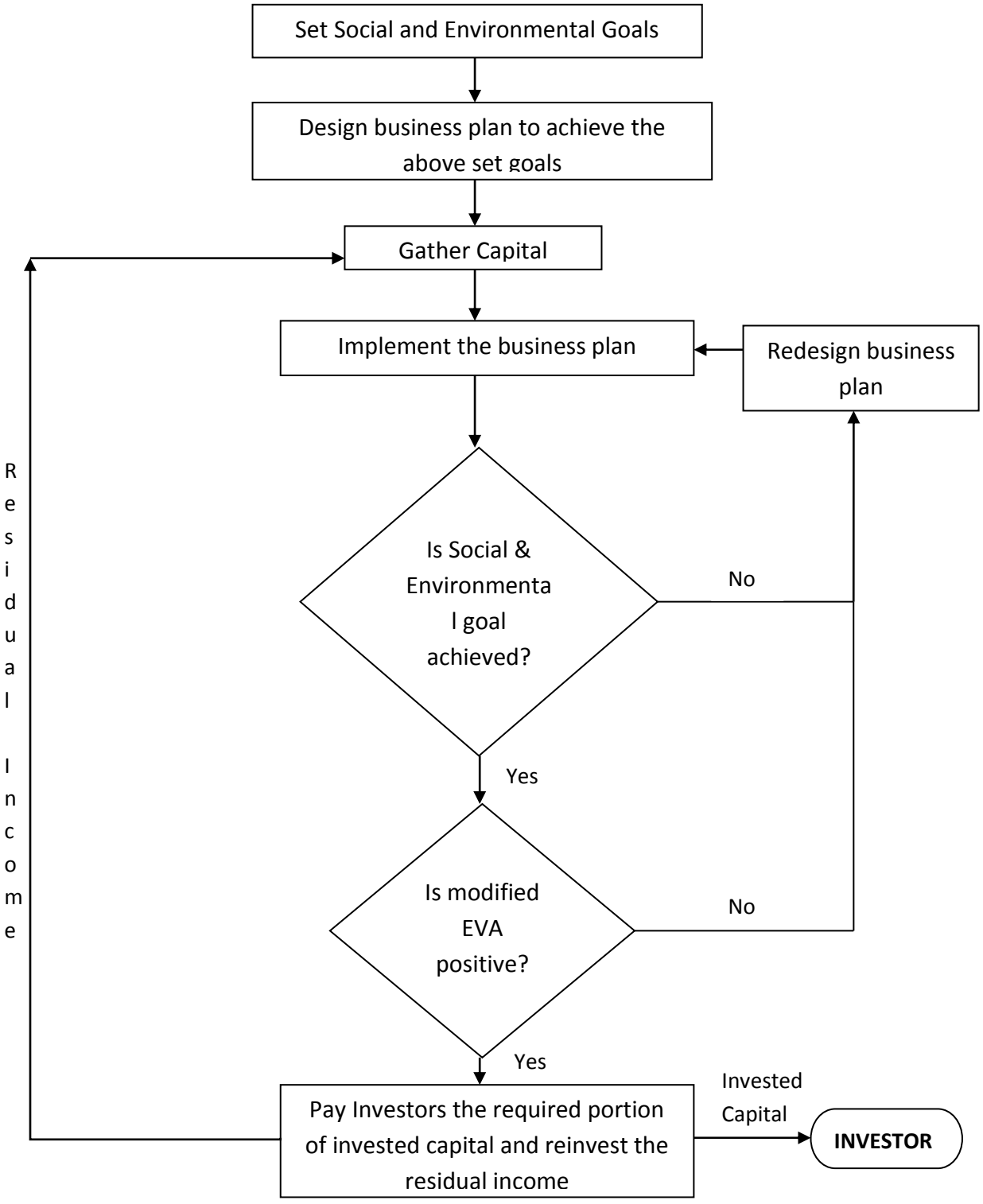
When applying EVA to social business, few factors are needed to be taken into account. Firstly, social business does not pay any extra return to its investors besides their initial invested capital (Yunus, Moingeon, and Ortega, 2010). Thus, instead of taking a required rate of return in the EVA calculation, only a simple percentage of periodic capital reimbursement should be considered. Also, if portion of the capital comes as loans, then instead of taking only the interest rate into account, the total periodic instalments of the loan should be considered. The periodic instalment calculated by banks or creditors includes not only the interest but also a portion of the principal. This way the calculated EVA will reflect the residual income of the business after capital reimbursement. So the modified EVA for social business is:

*EVA = NOPAT - loan instalment - (rate of capital reimbursement * Equity Capital)*

A positive value for the modified EVA indicates that the social business is not only generating enough revenues to cover its operational expenses but it can also return the

original invested capital to the investors and still have residual income left for expansion. The business then truly becomes self-sustaining. The implementation of EVA also differs from conventional business to social businesses. Conventional business will aim for a maximum positive value of EVA as a measure for its stockholder value maximization goal. Social businesses on the other hand will aim for only a positive value of EVA, regardless of the size, to maintain its sustainability. If put into a flow chart, then the implementation of the DBL approach along with EVA theory as a supporting tool in a social business setting would look like the one shown in figure 2.

Figure 2: Conceptualizing DBL measure and sustainability through EVA theory in a social business model



The flowchart in figure 2 clearly shows the superiority of the Social and Environmental values over the economic value in social business through the DBL approach. This is an obvious improvement from the triple bottom line method where all three were in equal grounds. In addition the economic value added (EVA) has been modified to be a necessary tool of measuring sustainability of social business after the social and environmental goals are achieved.

4. Conclusion

Conventional business has a primary goal of maximizing financial profit. These businesses are sometimes so occupied with this primary goal that their actions sometimes become detrimental to the society and environment. This was probably the main reason for the popularity of the triple bottom line, where John Elkington (1997) suggested that all businesses should strive for adding three distinct types of values to the business: social value, environmental value, and economic or financial value. Companies implementing the triple bottom line would now have to divide their capital and focus into three matters rather than only one. When applied to social business model the triple bottom line does not exist anymore. This paper states that social businesses should implement a double bottom line performance measurement approach. Social business is a financially self-sustaining business model. Thus profit maximization goal or the third bottom line is not applicable here. Instead social businesses focus on achieving social and environmental goals by catering to the bottom of the economic prosperity pyramid. The challenge of finding an integrated measure of all the bottom lines still exists. However it has been made easy for the social business as now the economic bottom line becomes merely a sustainability measure. As a result, the authors of this paper suggest a modified version of the Economic Value Added (EVA) formula where the periodic reimbursement of seed capital and loan instalments are deducted from operating profit to find the true residual income. A positive value is of EVA is the only requirement to maintain sustainability in a social business.

There is a limitation to this paper as it is a purely conceptual paper based only on literature review. It lacks empirical test of the proposed model. However this limitation creates vast opportunity for scholars to conduct further research on the social business. The authors of this paper propose scholars in the milieu of operations management to utilize value stream analysis (VSA) to implement social and environmental value as mentioned in this paper in a social business setting. Previous researchers have utilized the VSA tool to implement customer value only. However, there exists a gap in the existing body of knowledge to examine the VSA tool to implement the DBL in a social business in the form of social and environmental value in an integrated manner. Furthermore, there exists limited empirical evidence to the sustainability of a social business, although it is a key requirement of the social business model. In consequence, we propose researchers to examine the role of innovation and effective supply chain management practices to cultivate social and environmental sustainability in a social business. This paper opened up a new door both in the field of social business and financial sustainability.

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