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Price competition, short-termism and environmental performance

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ABSTRACT

This paper studies the relationships between the intensity of price competition, time horizon and environmental performance. We hypothesize that more intense price competition discourages environmental performance by inducing short-termism in companies. We test the hypotheses on a sample of 3152 companies from twelve European countries. Using structural equation modeling, test results show that price competition significantly shortens the time horizon that companies apply in strategic decisions and that (long) time horizon significantly increases their environmental performance. However, the net negative effect of the intensity of price competition on environmental performance is small in absolute terms. The policy implication is that there is no serious dilemma between fostering environmental performance on one hand and increasing consumer surplus by encouraging price competition on the other hand.

1. Introduction

Globalization and economic growth have put pressure on the environment because of negative external effects of production and consumption patterns. This challenge has generated a strong interest in corporate social responsibility (CSR) of companies. Indeed, CSR is often seen as 'corporate externality recognition' (Crouch, 2006). In 2011, the European Commission defined CSR as the responsibility of enterprises for their social and environmental impacts on society (European Commission, 2011, 6). An important policy question is how companies can be incentivized to adopt this responsibility and improve their corporate social performance (CSP). Whereas much is known of the micro barriers to CSP (Hemel and Cramer, 2002; Shi et al., 2008; Mathiyazhagan et al., 2013; Trianni et al., 2013), recently research has become more focused on the institutional roots of CSP (Brammer et al., 2012; Campbell, 2007; Gjølberg, 2009). One of the hypotheses that Campbell (2007) develops is that the odds of companies acting in socially responsible ways depend on the intensity of competition they face. If price competition is very intense, profit margins will be low and companies will have a strong incentive to save costs and this may cause them to act in socially irresponsible ways. As van de Ven and Jeurissen (2005) and Dubbink and Van der Putten (2008) argue: in a perfect market, individual companies will have hardly any room to pursue a pro-active policy on corporate social responsibility, because any cost disadvantage will harm their market share.

Building on institutional literature on CSP, other theoretical studies have conceptualized CSP as resulting from a combination of institutional factors and factors internal to the company (Delmas and Toffel, 2004; Aguilera et al., 2007; Brown et al., 2010). As yet underexposed in the literature, one of the internal factors through which price competition may affect CSP is the time horizon that the company employs in its strategic decision making. If companies are less profitable, they will have fewer resources and that makes it harder to make investments that are likely only to pay off in the long term and the resulting 'short-termism' may discourage CSP. As Yong Oh et al. (2011) argue, CSP investments are most likely to pay off in the long run. The longer the time horizon of the company, the more the company is concerned about corporate reputation and the quality of stakeholder management (Rehbein et al., 2013). Companies with a long-term orientation will therefore use CSP as an instrument to achieve long-term success. Based on this literature, we hypothesize that price competition reduces CSP by shortening the time horizon of the company.

One would expect that the links between competition, time horizon and CSP described above are particularly relevant for small

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and medium-sized companies (SMEs). The SME manager tends to focus on survival (Burt and Van der Heijden, 2003) and is therefore less likely to carry out strategic planning (Laverty, 2004; Ates and Bititci, 2011). The level playing field on which most SMEs operate means that they face severe competition and this puts profitability under pressure. Time, finances and a lack of skills and knowledge are commonly identified by SMEs as constraints to CSP (Studer et al., 2006). The long-term strategic benefits from CSP in terms of reputation, cost reduction, increased consumer demand and reduction in risks therefore often remain beyond the strategic horizon of SMEs. This implies that, as Lynch-Wood and Williamson (2007) argue, the social license motive will not be sufficient to induce SMEs to go beyond compliance to the law.

Currently, there is no empirical research that provides evidence of the mediation of the influence of price competition on CSP by time horizon. There are some studies that show that time horizon and CSP are related (Berger et al., 2007; Mallin et al., 2013; Neubaum and Zahra, 2006; Slawinski and Bansal, 2009; Yong Oh et al., 2011) and that competition is mildly antithetical to CSP (Cottrill, 1990). But the links between time horizon and the intensity of price competition, and how price competition affects CSP through time horizon, have not yet been researched. In this paper, we aim to fill this gap by using a large sample of 3152 companies from twelve European countries that largely consist of SMEs to analyze the relationship between price competition and CSP and the role of time horizon as mediator. Given the present state of research, our paper makes three contributions. First, we develop a conceptual framework that links price competition to CSP by postulating a mediating role of time horizon. Second, we test the model empirically using structural equation modeling, thus providing insight into the quantitative effects of price competition on time horizon and CSP, and the role of time horizon as a mediation path between price competition and CSP. The third contribution is that we test the model with a unique dataset that contains 3152 observations, of which more than 90% concern SMEs. The focus on SMEs in the sample is motivated by the expectation that the hypothesized relationships between price competition, time horizon and CSP might be particularly relevant for SMEs, as discussed above. Moreover, Hillary (2000) estimated that SMEs, defined as companies with less than 250 employees (European Commission, 2002), collectively account for up to 70% of industrial pollution worldwide. Hence, it is evidently important to study the CSP of SMEs.

In what follows, we first present the hypotheses, then describe the sample and methodology, report the results of the empirical analysis and discuss the findings.

2. Theoretical perspective and hypothesis development

2.1. Corporate social responsibility and environmental performance

Based on a study of 37 definitions, Dahlsrud (2008) identifies five common dimensions of corporate social responsibility: the environmental, economic, social, stakeholder, and the voluntariness dimension. These elements are nicely illustrated by the well-known definition of the European Commission (2001): 'Corporate social responsibility refers to a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.'

Another well-known definition that addresses the motivations for CSR initiatives is the four-part definition of Carroll (1979: 500): "The social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time." This definition separates out legal, ethical and philanthropic categories of responsibility from the primary, economic responsibility of the company. According to Carroll and Shabana (2010), the ethical and philanthropic obligations of the corporation towards are the essence of CSR.[1]

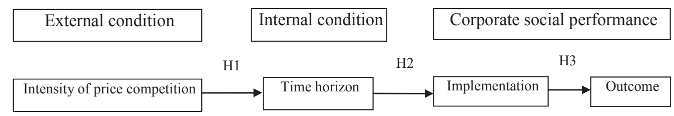

Fig. 1. Conceptual framework.

This paper analyses voluntary initiatives of companies to improve their environmental performance. Our analysis thus particularly links to the environmental and voluntariness dimensions distinguished by Dahlsrud and the ethical responsibility part of Carroll's categorization. The emphasis of our analysis is on the implementation of measures to improve environmental performance and their outcomes in terms of impacts on the environment. This focus on implementation and outcomes has particularly been stressed in the concept of corporate social performance (CSP). According to Orlitzky et al. (2003), one of the most influential, parsimonious and yet comprehensive conceptualizations of CSP is Wood's CSP model (Wood, 1991, 2010). In her model, Wood synthesizes the various previous attempts to model CSP (Carroll, 1979; Wartick and Cochran, 1985). Wood defines corporate social performance as "a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs and observable outcomes as they relate to the firm's societal relationships" (Wood, 1991: 693). Wood's model thus consists of three main parts. The first part concerns the principles of social responsibility and constitutes the motivations for companies to be involved in CSR; the second part the processes of social responsiveness; and the third part includes implementation of CSR through programs as well as the social impacts in terms of the effects on stakeholders and society. By analyzing implementation and outcomes of environmental performance, our paper particularly links to the third part of Wood's model, which represents, according to Wood (2010), a critical missing piece in earlier CSP models.

2.2. Conceptual framework

Following recent theoretical studies (Delmas and Toffel, 2004; Aguilera et al., 2007; Brown et al., 2010), we conceptualize CSP as resulting from a combination of external factors and internal factors (see Fig. 1). More specifically, we assume that the implementation of CSR is related to the company's time horizon (internal condition) and that the company's time horizon depends on the intensity of price competition (external condition). Below, we first argue that price competition is expected to decrease the time horizon of a company. Then we explain that the implementation of CSR will increase with the time horizon that the company applies in its strategic decisions. Finally, we describe the relationship between implementation of CSR and CSR outcomes.

[1] Lozano (2012) provides more insight into the multidimensionality of various kinds of voluntary corporate initiatives (including CSR) by analyzing how 16 initiatives contribute to four aspects of sustainability (economic, environmental, social, and time) and the company system, how they are linked to each other, and what their advantages and disadvantages are.