



Analysis

When Does Corporate Sustainability Performance Pay off? The Impact of Country-Level Sustainability Performance

Chengyong Xiao^{a,b,*}, Qian Wang^a, Taco van der Vaart^b, Dirk Pieter van Donk^b

^a School of Economics and Management, University of Chinese Academy of Sciences, Zhongguancun Donglu 80, 100190 Beijing, China

^b Department of Operations, Faculty of Economics and Business, University of Groningen, Nettelbosje 2, 9747 AE Groningen, The Netherlands

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ABSTRACT

There has been considerable debate on and research efforts into the question as to if, and if so when, improving corporate sustainability performance is not only beneficial for social and environmental wellbeing but also for the financial wellbeing of a firm. So far, the literature has reported mixed results on the relationship between corporate sustainability and financial performance. Drawing on instrumental stakeholder theory, we develop a focal hypothesis arguing that the financial effect of corporate sustainability performance is negatively impacted by country-level sustainability performance because stakeholders will take a firm's sustainability improvement for granted in countries with good social and environmental performance. We test this focal hypothesis in a cross-country setting drawing on the 6th International Manufacturing Strategy Survey. The current study supplements these data with secondary data drawn from the Human Development Index and the Environmental Performance Index. The results support our hypothesis that firms in countries with higher levels of sustainability performance generally find it more difficult to capitalize on corporate sustainability performance than do their counterparts in countries with relatively low levels of sustainability performance. This outcome helps to explain the mixed findings in the literature. Moreover, our study suggests that sustainability management can be a source of competitive advantage for firms located in emerging and developing countries, where in general the level of sustainability performance is relatively low.

1. Introduction

Managers and researchers around the globe acknowledge that it is crucial for firms to improve their corporate sustainability performance (CSP), which indicates a firm's contribution to environmental protection and social development (Wagner, 2010). However, there is less unanimity regarding the financial benefits that can be expected from such improvements. This study argues that stakeholder responses to CSP improvements are influenced by the *country-level sustainability performance*, a measure of how well a country performs in terms of high-priority social and environmental issues (Siche et al., 2008; Wagner, 2010). Specifically, we submit that CSP improvements can be financially effective in countries with relatively low levels of sustainability performance, whereas similar investments may have very limited financial effect in countries with high levels of sustainability performance.

Empirical studies exploring the relationship between CSP and corporate financial performance (CFP) have variously reported positive,

non-significant, and even negative results (Margolis et al., 2007; Flammer, 2015). This indicates that even after more than thirty years of research, there is no clear answer to the question as to whether CSP pays off (Barnett, 2007). In their attempts to explain these mixed results, researchers have explored how firm-level factors, such as engagement strategy (Tang et al., 2012) and stakeholder influence capacity (Barnett and Salomon, 2012), may impact on the CSP-CFP relationship. In contrast, systematic reviews of the relevant literature (Lee, 2008; Aguinis and Glavas, 2012) show that researchers have barely explored the potential impact of societal factors on this relationship, even though it is widely accepted that the financial effect of CSP is primarily rooted in firm-society interactions and positive stakeholder responses (Jones, 1995; Barnett, 2007). As Arya and Zhang (2009) and Aguinis and Glavas (2012) put it, without a clear understanding of societal impact on the financial effect of CSP, knowledge regarding the CSP-CFP relationship can, at best, be described as partial. This study aims to close this gap and explores societal impact on the financial effect of CSP.

Abbreviations: CFP, corporate financial performance; CLSP, country-level sustainability performance; CSP, corporate sustainability performance; EPI, environmental performance index; HDI, human development index; HLM, hierarchical linear modeling; IMSS VI, the 6th International Manufacturing Strategy Survey

* Corresponding author at: Dui-651, Nettelbosje 2, 9747 AE Groningen, The Netherlands.

E-mail addresses: c.xiao@rug.nl (C. Xiao), qianwang@ucas.ac.cn (Q. Wang), j.t.van.der.vaart@rug.nl (T. van der Vaart), d.p.van.donk@rug.nl (D.P. van Donk).

Our focus on societal impact is further inspired by several pairs of empirical studies on the CSP-CFP relationship in developed countries, e.g., [Shane and Spicer \(1983\)](#) versus [David Diltz \(1995\)](#), and [Spicer \(1978\)](#) versus [Pava and Krausz \(1996\)](#). The earlier study in both pairs found positive CSP-CFP relationships, whereas the more recent studies did not find support for such relationships in similar contexts using similar measurements. It is plausible that country-level sustainability performance could explain this apparent inconsistency in the CSP-CFP relationship. In the 1970s and 1980s the sustainability performance of developed countries was generally low. Although there was little external pressure to improve CSP, firms that did so could gain significant financial benefits because these improvements could advance firm-stakeholder relationships ([Jones, 1995; Barnett, 2007](#)). Since then, developed countries have enforced laws and regulations on environmental integrity and social equity, and there have been substantial improvements in sustainability performance over the past two decades. As a consequence, stakeholders are no longer that sensitive and responsive to firms improving their social and environmental performance, making it difficult for firms to gain financial benefits from such improvements ([Barnett, 2007](#)). Based on these observations and reasoning, we hypothesize that country-level sustainability performance can negatively influence the financial effect of CSP. To test this, this study evaluates the CSP-CFP relationship in a cross-country setting drawing on the data of the 6th International Manufacturing Strategy Survey (IMSS VI), which are gathered in 22 countries characterized by considerable differences in country-level sustainability performance.

This study makes an important contribution to the CSP literature by extending it to include country-level sustainability performance in the CSP-CFP relationship. So far, researchers have mainly focused on firm-level factors that may impact on the financial effect of CSP. In reality, CSP is an area of extensive and enduring firm-society interactions ([Matten and Moon, 2008; Lee, 2008](#)) and the financial effect of CSP largely stems from these firm-society interactions ([Jones, 1995; Barnett, 2007](#)). As such, this study provides novel insights into the contingent relationship between CSP and CFP, and it contributes to a more nuanced understanding of the financial effect of CSP. Moreover, this study contributes to the literature by testing the CSP-CFP relationship in a sample of manufacturers located in 22 countries. Our findings show that the financial effect of corporate sustainability performance differs across countries. As such, we suggest that a global approach toward sustainable development should also take into account country differences.

The remainder of this paper is structured as follows. The second section introduces the theoretical foundation of the CSP-CFP relationship and various studies that have addressed the mixed financial effects of CSP. Further, this section also introduces country-level sustainability performance and develops the hypotheses of this study. The characteristics of the dataset used and the statistical methods applied are discussed in the third section. The fourth section reports the results. The fifth section discusses the implications of the findings for CSP theories and practices, the limitations of this study, and research avenues that are worthy of further exploration. The final section draws conclusions.

2. Theoretical Foundation and Hypothesis Development

This section consists of two subsections. In the first, we briefly introduce corporate sustainability performance and the mechanism through which CSP improvements can contribute to corporate financial performance, and discuss the firm-level factors that have been found to influence the CSP-CFP relationship. The second subsection introduces country-level sustainability performance and discusses how this factor can impact on the financial effect of CSP.

2.1. The CSP-CFP Relationship

CSP reflects a firm's impact on society, including employees,

customers, suppliers, and local communities, and on the natural environment ([Hillman and Keim, 2001; Matten and Moon, 2008](#)). As such, CSP is conceptualized as a broad construct consisting of social/human and environmental dimensions ([Perrini et al., 2011](#)). The environmental aspect of CSP is relatively well understood and covers the issues of resource preservation, energy consumption, waste minimization, and emission/pollution abatement ([Krause et al., 2009; Wagner, 2010](#)). The social or human aspect of CSP has a broader scope and concerns poverty alleviation, health and safety of employees, protection of human rights, and participation in diverse social initiatives ([Krause et al., 2009; Perrini et al., 2011](#)).

Several theories have argued for a positive CSP-CFP relationship, such as resource productivity theory ([Porter and van der Linde, 1995](#)), the natural resource-based view of the firm ([Hart, 1995; Russo and Fouts, 1997](#)), and instrumental stakeholder theory ([Jones, 1995; Barnett, 2007](#)). Among them, instrumental stakeholder theory has been more intensively used and empirically tested. More importantly, given its focus on stakeholders it fits with the notion that CSP is shaped within a societal context and in interaction with the firm's environment. Instrumental stakeholder theory argues that CSP improvements can contribute to CFP by advancing a firm's relationships with its internal and external stakeholders ([Barnett, 2007; Jones, 1995](#)). In more detail, it is argued that internal stakeholders such as shop-floor workers and managers will respond positively to a firm's CSP improvements, such as initiatives to manage occupational health/safety risks and programs on work-life balance ([Jones, 1995; Wicks et al., 1999](#)). These favorable responses lead to improved human capital and innovation capability for firms, which in turn can result in reduced costs and better financial performance ([Perrini et al., 2011](#)). Similarly, CSP improvements can deliver positive signals to external stakeholders, such as customers, non-governmental organizations (NGOs), the general public, and governmental agencies, about a firm's commitment to social and environmental wellbeing ([Perrini et al., 2011](#)). These stakeholders will take these improvements (e.g., environmental protection and charitable giving) as evidence that the firm is trustworthy and reliable. Such firms can benefit from an improved reputation and customer satisfaction through charging price premiums and the expanded marketing opportunities ([Luo and Bhattacharya, 2006; Perrini et al., 2011; Surroca et al., 2010](#)). This is summarized in our first hypothesis:

Hypothesis 1. *There is a positive relationship between corporate sustainability performance and corporate financial performance.*

2.2. The Impact of Country-Level Sustainability Performance on the CSP-CFP Relationship

Although the theoretical framework underpinning the CSP-CFP relationship outlined above is widely accepted ([Barnett, 2007](#)), systematic reviews ([Margolis et al., 2007; Orlitzky et al., 2003](#)) show that the large number of empirical studies testing this relationship have produced mixed results. The mixed findings, summarized by [Barnett \(2007\)](#) and [Margolis and Walsh \(2003\)](#), indicate that CSP can have varying financial effects across firms and contexts. As a result, researchers have started to explore the potential contingencies that might influence the financial effect of CSP ([Barnett and Salomon, 2012; Servaes and Tamayo, 2013; Tang et al., 2012; Wang and Choi, 2013](#)). Several firm-level factors have been identified, including stakeholder influence capability ([Barnett and Salomon, 2012](#)), customer awareness ([Servaes and Tamayo, 2013](#)), and engagement strategy ([Tang et al., 2012](#)). For instance, [Barnett and Salomon \(2012\)](#) found that the CSP-CFP relationship is positively moderated by stakeholder influence capacity, defined as the ability of a firm to “identify, act on, and profit from opportunities to improve stakeholder relationships through corporate social responsibility” (p. 1306).

In addition to these firm-level factors, factors and developments related to sustainability performance at the country level can also

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