Journal of Environmental Management 218 (2018) 322–332

Contents lists available at ScienceDirect

Journal of Environmental Management

journal homepage: www.elsevier.com/locate/jenvman

Research article

The moderating role of stakeholder management and societal characteristics in the relationship between corporate environmental and financial performance

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A R T I C L E I N F O

Article history:
Received 12 December 2017
Received in revised form
16 February 2018
Accepted 1 April 2018

JEL classification:
M14
M41
Q56

Keywords:
Corporate financial performance
Corporate social responsibility
Environmental performance
Stakeholder engagement
Stakeholder prioritization

A B S T R A C T

This study contributes to the debate about the moderating factors that affect the relationship between environmental and financial performance. Combining stakeholder theory, stakeholder salience, and legitimacy theory, and based on a large international sample, we demonstrate that stakeholder prioritization and engagement jointly positively moderate the relationship between environmental and financial performance. However, this moderating effect is only found when both formal and informal societal characteristics are strong and support the business environment surrounding the firm and its stakeholders. Contributions and implications for managers and regulators are discussed.

1. Introduction

Despite environmental, social, and governance information and activities being proved to be useful for various economic agents and for the broader economic and business environment (Amel-Zadeh and Serafeim, 2017), researchers have spent 40 years debating whether firms themselves benefit from such activities. We join this debate by investigating the moderating role of stakeholder management and societal characteristics on the relationship between corporate sustainability and corporate financial performance.

From a theoretical point of view, two streams of literature have provided opposite views on this relationship (El Ghoul et al., 2017). On one hand, according to neoclassical theory, the integration of environmental and social policies into a firm's strategy increases its costs and potentially destroys shareholders' wealth (e.g., Palmer et al., 1995). On the other hand, the positive revisionist approach suggests that such activities increase both private and public wealth (e.g., Porter and Kramer, 2011). Applying the latter approach, stakeholder theory underpins a positive relationship between corporate sustainability and corporate financial performance (e.g., Wang et al., 2016).

Empirical studies have not succeeded in clarifying the theoretical debate because of inconsistent results (Grewatsch and Kleindienst, 2015). A potential motivation is that examining the link between corporate sustainability and corporate financial performance "spans academic disciplines (i.e., management, finance, economics, accounting, and marketing) and theoretical lenses making synthesis and interpretation difficult" (Dixon-Fowler et al., 2013, p. 354). As a result, in recent years the academic debate has moved on to concentrate on the contingent aspects that moderate the link, shifting from answering the question "Does it pay to be good?" to "When does it pay to be good?" (Orlitzky et al., 2011).

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https://doi.org/10.1016/j.jenvman.2018.04.005
0301-4797/

Prior literature identifies two main topics that need to be considered when investigating the consequences of corporate sustainability actions. First, stakeholders are able to evaluate corporate sustainability actions when managers listen, coordinate, and operate in ways that allow each stakeholder group to feel their views are heard (Kaptein and van Tulder, 2003). To achieve this objective, managers should implement and communicate corporate sustainability in a way that alleviates concerns from stakeholders (Selmier et al., 2015). Conversely, stakeholders' ability to evaluate corporate sustainability is reduced as they are unable to disaggregate responsible and irresponsible actions (Strike et al., 2006). Second, societal characteristics are fundamental in understanding causes and consequences of corporate sustainability. In fact, institutional pressure is a key factor in determining a firm's need for societal goodwill (Husted and Allen, 2006). Thus, both economic and legitimacy-seeking arguments influence the implementation and effectiveness of corporate sustainability practices (Young and Makhija, 2014).

Perhaps surprisingly, prior literature neglected the contemporaneous examination of the moderating effect of stakeholder management and societal characteristics on the relationship between corporate sustainability and corporate financial performance. We investigate the relationship between corporate environmental performance (CEP)[1] and corporate financial performance (CFP) using three theoretical lenses: stakeholder theory, stakeholder salience, and legitimacy theory. Building on the interaction between stakeholder theory and stakeholder salience, we first hypothesize that the link between CEP and CFP is stronger when firms decide to manage relationships with stakeholders by prioritization and engagement. Reflecting on legitimacy theory, and its interplay with stakeholder theory and stakeholder salience, we argue that the positive moderating effect of stakeholder prioritization and engagement on the relationship between CEP and CFP only holds when formal and informal societal characteristics are strong.

Using an international sample of 13,627 firm-year observations from 37 countries spanning the period 2003–2014, we confirm that stakeholder prioritization and engagement positively moderate the association between CEP and CFP only when they are jointly implemented. Additionally, we document that these results are valid only when high formal and informal societal characteristics support the business environment surrounding the firm and its stakeholders.

Our study contributes to the debate on moderators of the relationship between CEP and CFP in three ways. First, we investigate the simultaneous effect of two stakeholder management tools likely to influence the relationship between CEP and CFP that, to our knowledge, have never been studied together. This allows us to provide a more complex and systematic view of the matter, which is missing in prior literature. We show that stakeholder management needs to be conscientiously implemented through both prioritization and engagement to positively affect the CEP-CFP relationship. In doing so, responding to the plea in prior literature to invest in theory building, we contribute by constructing a framework based on three different theories. This also allows us to select moderators that do not fall into list of the "usual suspects" (Grewatsch and Kleindienst, 2015). Second, our results provide support for managers to design better environmental strategies. In fact, by prioritizing the needs of stakeholders and engaging them in the decision-making process, managers will be able to identify and select the most appropriate and profitable environmentally responsible investment strategies. We also advise managers about the importance of concordance between prioritization and engagement strategies, and inform managers of multinational companies about the role of societal characteristics and country differences in supporting the moderating role of stakeholder prioritization and engagement on the relationship between CEP and CFP. Finally, policymakers can also benefit from our results. While our results show that being more environmentally friendly always pays off in terms of financial performance, they also reveal that the effectiveness of environmental management practices critically depends on societal characteristics. Reflecting on legitimacy theory, policymakers can design appropriate environmental regulations to induce virtuous environmental management practices that enhance the effect of environmental performance on financial performance.

The remainder of the paper is organized as follows. We discuss the theoretical framework and the three theories used to develop the hypotheses. Next, we explain the sample, data, and methodology of this study. Finally, we report the results and offer a discussion of the main findings and concluding remarks.

2. Theoretical framework

Stakeholder theory and the resource-based view are generally used to support a positive relationship between CEP and CFP (Grewatsch and Kleindienst, 2015; Ramanathan, 2016; Wang et al., 2016). The major difference between these two theories is that the former focuses on maximizing financial performance by managing external constraints imposed by stakeholders (Freeman, 1984). Conversely, the latter emphasizes the creation of valuable, rare, inimitable, and non-substitutable resources as a driver of enhanced financial performance (Russo and Fouts, 1997). This study focuses on stakeholder theory, since it allows us to bridge internal managerial practices to both external needs and pressures imposed by stakeholders and expectations derived from societal characteristics. We use the lens of stakeholder salience to examine managerial practices and analyze societal characteristics from a legitimacy theory perspective.

According to stakeholder theory, stakeholders are defined as all individuals connected directly, or indirectly, with the firm, and are those who may affect or be affected by the achievement of the firm's objectives (Freeman, 1984). Based on this, firms must look beyond merely maximizing shareholders' wealth, and consider all individuals who have an interest in the firm's operations (e.g., Parmar et al., 2010). By satisfying the needs of different groups of stakeholders, firms can enhance financial performance through increases in effectiveness and efficiency, which will not occur if the needs of any group are ignored (Platonova et al., 2016). Given its innate characteristics, stakeholder theory has also become a useful framework for linking stakeholders' pressure for implementation of good firm-level environmental strategies to improved financial performance (Cordeiro and Tewari, 2015). In fact, sound environmental performance lowers the probability that stakeholders will undermine firm operations through penalties, legal actions, or customer boycotts (Cordeiro and Tewari, 2015), thus leading to a competitive advantage for the firm (Wang et al., 2016).

While stakeholder theory suggests that taking care of all stakeholders is fundamental for a firm's survival, it is also commonly acknowledged that managers cannot satisfy all stakeholders' needs due to limited resources (Unerman, and Bennett, 2004). Boesso and Kumar (2009a, p. 163) argue that "the pragmatic reality is that, despite their obligations to a range of multiple primary stakeholders, managers cannot attend to all of the actual and potential claims of all stakeholders." To rationally solve

[1] We concentrate on CEP since prior literature documents a relatively strong interest in environmental information and activities compared to other elements of corporate sustainability (Eccles et al., 2011).