Forest Policy and Economics 13 (2011) 113–123

Contents lists available at ScienceDirect

Forest Policy and Economics

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

Corporate responsibility and sustainable competitive advantage in forest-based industry: Complementary or conflicting goals?

N. Li, A. Toppinen *

Department of Forest Sciences, University of Helsinki, P. O. Box 27, 00014 Helsingin Yliopisto, Finland

ARTICLE INFO

Article history:
Received 7 September 2009
Received in revised form 14 May 2010
Accepted 4 June 2010
Available online 9 August 2010

Keywords:
Corporate responsibility
Forest-based industry
Single- and double-loop organizational learning
Resource-based view
Competitive advantage
Forest certification

ABSTRACT

The growing public interest in and global consciousness of environmental and social issues have intensified pressures on forest industry companies in their efforts to effectively balance potentially conflicting stakeholder demands. In this paper, we conceptually analyze corporate responsibility (CR) in forest-based industry by theoretically differentiating between three approaches driving CR: the "trade-off" hypothesis, the "profit-maximizing" corporate responsibility conjecture, and the "corporate social impact" hypothesis. We use a survey of existing studies to assess the current stage of CR adoption in forest-based industry and to form a basis for evaluating the wider importance of CR in business, as well as to formulate hypotheses for future research. In conclusion, companies covered in previous research in this study appear to have adopted CR activities mainly with the profit-maximizing assumption. As the continued growth of ethical markets and socially responsible investment (SRI) presents both a threat and an opportunity for forest industry companies, a lasting case for CR in business could only be made by embracing CR principles with radical changes in the fundamental values, policy principles and operational procedures through double-loop organizational learning.

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1. Introduction

In recent years, "socio-economic and social-legal developments have shifted considerable social power to the private economy in general and more specially to large corporations." (Keinert, 2008, p. 19). The central role of business has extended from that of the traditional economic actor to being a political and social actor. Concerns about corporate responsibility (hereinafter CR) have consequently become an increasingly high profile issue in many countries and globalizing industries. Recent studies have also stressed that, in addition to economic assessments, the environmental and social impact from international operations should also be integrated more closely into corporate strategic decision-making (Christmann, 2004; Vermeulen and Ras, 2006; Locke and Romis, 2007). Market instruments and regulations are evidently not always sufficient to balance the conflicting demands of different stakeholder groups (Amaeshi and Crane, 2006). Numerous corporate scandals in the 1990s, at Shell and Nike, for example, and more recently at Enron and Worldcom, have raised significant public concerns about ethical leadership within corporations. As Maak (2007) observes, such corporate scandals have triggered a broad discussion on the role of business in society, especially their legitimacy, obligations, and responsibility in relation to sustainable global development.

Socially responsible investment (SRI) is more wide spread than ever in the U.S., Europe and Asia (Krumsick, 2003). The last half century has witnessed the evolution of SRI and its associated substantial changes, from the fair labour practices in the 1940s (Martin, 1986), value-based investing in the 1970s (Spencer, 2001), and human rights violations and global labour standards in the 1990s (Rivoli, 2003), to the most recent concerns that involve corporate governance (Moir, 2001).

The rising awareness of social consciousness and actions leading to commercial success has also inspired many researchers to study the linkage between CR and financial performance, especially in the area of SRI (Margolis and Walsh, 2001; see also surveys in Orlitzky et al., 2003 and Salzmann et al., 2005). A recent survey by Kurucz et al. (2008) identified four general types of CR as a business case, i.e., the motivation for firms to engage in CR to reduce costs and risks in their operations, to achieve a competitive advantage, to improve their reputation and legitimacy, and to integrate stakeholder interests to create value on multiple fronts (i.e., synergistic value creation).

Studies on company efforts to integrate the CR concept into their organizational practices have shown that lack of understanding of the rising demands of stakeholders, ethical values and commitment backed by the top management, among other things, often lead to a failure of CR implementation (see CBSR, 2001; Nattrass and Altomare, 2002; Willard, 2005). This indicates a need to make internal organizational changes in corporate management, and therefore much greater attention to such things as aspects of organizational learning (e.g., Kell, 2003; Waddock, 2003).

Among environmentally-sensitive sectors, the forest-based industry has a crucial role in global sustainable development, not only because of its unique raw material basis, but also because of the ongoing globalization of industry. The ever-growing public interest in and global

* Corresponding author. Tel.: +358 50 415 0219.
E-mail addresses: ning.li@helsinki.fi (N. Li), anne.toppinen@helsinki.fi (A. Toppinen).

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doi:10.1016/j.forpol.2010.06.002

consciousness of environmental and social issues have intensified pressures on forest industry companies in their efforts to effectively balance potentially conflicting stakeholder demands, and to rethink their business strategies. While issues such as the distribution of global wealth, human rights, and the preservation of the natural environment are high on the political agenda of governments, business leaders are also expected to play a more active role in furthering positive social goals and countering the new threats of destructive forces by, for example, reducing their environmental footprints, contributing to poverty alleviation, combating climate change, and promoting sustainable forest management (see Vidal and Kozak, 2008a). Such endeavours would require responsible global leaders with responsible mindsets to act as responsible citizens.

In the context of forest-based industry, CR has not been explored specifically from a business strategy and financial performance point of view. Our aim here is to approach the CR-financial performance relationship theoretically from three alternative standpoints: first, the neo-classical economic point of view as a trade-off between other activities; second, the profit-maximizing conjecture to reap anticipated benefits and, third, the social impact point of view to meet the needs and expectations of various stakeholders. Next, we synthesize existing empirical evidence of CR in forest-based industry and, based on the literature review and analysis of the dominant industry structure and market characteristics, we formulate a state-of-the-art understanding of the importance of CR in the field and develop hypotheses for further empirical research, followed by conclusions and managerial implications.

2. Theoretical background

As anticipated, analysis of the corporate responsibility–financial performance relationship can be approached theoretically from three main standpoints. First, *the trade-off hypothesis* reflects Friedman's neo-classical argument (1970) that the social responsibility of business is to increase profits and assumes that the increasing cost of CR investment inevitably reduces corporate profitability. The traditional trade-off hypothesis observes a negative relationship between CR and financial performance (see, e.g., Vance, 1975; Palmer et al., 1995; Jaffe et al., 1995). Advocates of such a view insist that the adoption of CR to meet the demands of various stakeholder groups creates additional constraints on the corporate pursuit of success by incurring greater costs (e.g., in terms of management time, capital investment, and operating cost). Accelerated by the 'win–win' hypothesis of Porter and van der Linde (1995) and the 'it depends' hypothesis of Reinhardt (1998), the CR debate has moved from analysing whether businesses should make a substantial commitment to when and how such a commitment should be made (Hillman and Keim, 2001; King and Lenox, 2001; Wagner et al., 2001; Porter and Kramer, 1999, 2002, 2006; Smith, 1994, 2003; Salzmann et al., 2005; Kotler and Lee, 2005; Husted and Salazar, 2006; Orsato, 2006).[1] Consequently, it has been hypothesized that the adoption of CR allows companies to sustain financial performance and should be integrated into corporate strategy (McWilliams and Siegel, 2001; McWilliams et al., 2006).

Other theoretical approaches than the trade-off model assume that there is indeed a case for CR. Based on the rapidly-expanding research and media attention related to CR, one might be also tempted to reject the purely neo-classical theory and consequently move on to determine and analyze the types of impact CR has and under what circumstances. According to the *profit-maximizing conjecture*, the anticipated benefits of actions are a consequence of implementing company strategy and not mere company-level altruism. A rapidly-growing body of research has advocated the argument by Peter Drucker (1984), who endowed CR with new meaning by stressing that profitability and responsibility are compatible, the challenge being to convert business social responsibility into business opportunities. Today, as it has become harder and harder to compete by the traditional means of product differentiation, there is an international convergence on the rise of intangible resources as a source of sustainable competitive advantage (SCA). In line with the prevailing theory of the firm, the resource-based view (RBV) (Wernerfelt, 1984; Barney, 1991) is that such intangible resources include, among other things, reputation, brand value, skilled employees, and creation of innovation and knowledge. The utilization of both tangible and intangible resources creates the basis for company-specific capabilities (Teece et al., 1997), but intangible ones are more likely to lead to innovation and competitive advantage because they are more likely to be rare, valuable, non-imitable and non-substitutable (Barney, 1991). In line with RBV, Branco and Rodriguez (2006) claim that investment in socially responsible activities may have both internal and external benefits by helping a firm to develop new resources and capabilities. Furthermore, Hillman and Keim (2001) stress that the corporate competitive advantages are relationship-oriented, and are influenced by the interaction between key stakeholders and the firm.

Because the numerous benefits to be obtained by respectful and proactive social action are tied to product and process advantages, which are in turn linked to corporate reputation, employee loyalty, and stakeholder commitment, the role of intangible resources is indeed paramount in formulating and implementing CR strategy. The application of intangible resources to better capitalize on both market and social opportunities thus represents a unique, dynamic positioning for each firm. Since product differentiation has become more difficult, many companies are adjusting their own identities from the sustainability perspective as a way of building up brand personality and equity. Keim (1978) perceived CR as enlightened self-interest; Russo and Fouts (1997) found that firms with higher levels of environmental performance had superior financial performance; McWilliams and Siegel (2001) sketch a simple firm theory model of profit-maximizing CR by using the RBV framework; Porter and Kramer (2002) assert that corporate philanthropy can contribute to corporate competitive advantage; Prahalad (2003) argues that CR strategies can simultaneously serve the poor and make profits; Kotler and Lee (2005) illustrate how different CSR approaches can combine success and value creation for stakeholders. Husted and Salazar (2006) assert that CR is compatible with Friedman's arguments (1970) if one carefully calculates what the optimal level of social output for maximizing shareholder value is in each situation.[2] On this view, a strategic rather than an altruistic CR approach would ultimately be more profitable for the firm (Husted and Salazar, 2006).

This leads to the third theoretical perspective, the *CR social impact hypothesis,* which assumes that meeting the needs and expectations of various stakeholders affects firms positively, for instance, though better employee retention, decreased business risk or providing access to ethical investment funds. A growing body of research has taken different approaches, aiming to provide practical and feasible frameworks for social performance evaluation. Numerous recent studies have provided indications of the positive influence of CR on different stakeholder groups (e.g., Pave and Krausz, 1996; Preston and O'Bannon, 1997; Brown and Dacin, 1997; Green and Turban, 2000; Backhaus et al., 2002; Orlitzky et al., 2003). Social performance and impact are, however, difficult to measure because good social performance often results in intangible assets that materialize in the long-term, and they are more complex in evaluation and quantification than the tangible resources.

[1] The strong cultural, social and historical changes in the general context occurring from 1970 to the present have naturally had an impact on the debate.

[2] A recent study by Lankoski (2008) suggests that the optimal level of CR outcomes for a profit-maximizing firm is a moving target that requires constant monitoring of stakeholder preferences, technological solutions and regulatory developments. Despite the mixed empirical evidence obtained from the accumulating studies on the relationship between CR and economic performance, Lankoski proposes that this relationship is case-specific; a win–win situation does exist, but not always.

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