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Wien, Januar 2012 Valeriu Vetiul

I would like to dedicate this thesis to my dear family,
who offered their tremendous support during my education

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List of abbreviations

BCS - Business Case for Sustainability

CFP - Corporate Financial Performance

CSP - Corporate Social Performance

CSR - Corporate Social Responsibility

DJSGI - Dow Jones Sustainability Group Index

FDI - Foreign Direct Investment

FSA - Firm-specific advantage

GDP - Gross Domestic Product

MNE - Multinational Enterprise

MNC - Multinational Corporation

NGO - Non-governmental Organization

SD - Sustainable Development

UNCTAD - United Nations Conference on Trade and Development

The strategist who is unconcerned by sustainability is akin to an architect who cares not whether their building stands or falls."

James Mackenzie, NHS Sustainable Development Unit (2010)

1. Introduction

Due to pressing environmental, social and economic challenges facing our society today, the subject of sustainable development has become increasingly interesting for business scholars. The Journal of World Business has dedicated a special issue to the subject of sustainable business in 2010, and identifies it as “the most pressing intellectual and practical challenge facing world business, surpassing even global financial issues” (Journal of World Business, 2010, page 323).

While some scholars argue that the term “sustainable business” is an oxymoron, meaning that business and sustainability are self-excluding terms, others speak for a transformation of usual business practices so as to meet the rising environmental, social and economic challenges of this century.

With lowered trade barriers and increased homogeneity of markets through various trade-agreements and economic areas such as the European Economic Area, the Asian-Pacific Economic Cooperation or the North American Free Trade Agreement, multinational corporations have become increasingly influential institutions, whose sales sometimes exceed nations in their GDP. Anderson and Cavanagh (2000) of the Institute for Policy Studies released a report in December 2000, in which it is found that of the 100 largest economies in the world, 51 are corporations. The comparison of the sales of corporations with the GDP of nations might not be fully valid, as the GDP represents the sum of the value added of each producer and the sales is the sum of goods and services sold, even if they are sold several times as semi-final products during the value-adding activities. This leads to double counting and thus inflates the sales numbers. But even if the inconsistency in measures is eliminated, so that instead of sales only the value added is considered, of the 100 world economies, 37 will still be corporations (De Grauwe and Camerman, 2002). Thus, the role and influence of multinational corporations on the international scene cannot be ignored.

Many less developed countries, in which MNEs operate, have adopted liberal economic development policies in the last decades in order to attract foreign direct

investment. Also, MNEs are attracted to developing markets because of the presence of fast growing consumer markets, lower production costs and important unexplored natural resources. These trends have led to record levels of foreign direct investment to less developed countries (Moser 2001). According to a 2011 report published by the United Nations Conference on Trade and Investment (UNCTAD), the year 2010 has seen, for the first time, higher FDI flows to transition and developing economies than to developed economies[1]. This was mainly due to the decreased FDI flows to developed economies after the 2008 financial crisis, yet it goes to show the increased relative importance of the role of MNEs in the developing economies.

Due to their nature, MNEs have operations in many foreign countries, and thus have to pass not only the test of short-term profitability, but also that of serving the public good in order to receive the social license to operate in those markets. MNEs have to recognize their perceived role as integral part of foreign societies and respond appropriately to both current and future stakeholder expectations (Chen et al., 2009).

Regardless of the actual influence that multinational corporations might have on the global scene, they are being accused of being the cause for pressing global problems such as environmental degradation, climate change and economic inequality. Yet their potential as being part of the solution is being increasingly recognized, so as to stir interest in the research of sustainable development opportunities of international business. As a result, managers are incorporating the possible advantages or costs of sustainable operations into their choice of international strategies.

Some multinational corporations approached this challenge as an opportunity to gain competitive advantage by employing environmental and social management systems, which were expected to increase financial performance. Yet others have seen sustainable development practices as a cost necessary to keep them competitive. According to a study by Ernst & Young among 114 companies from the Global 1000, 73% responded that corporate sustainability is on the board's agenda,

[1] UNCTAD Global Investment Trends Monitor No. 5 from 17 January 2011, page 1.

94% thought that a CS strategy might lead to a better financial performance, yet only 11% was actually implementing it (Marrewijk, 2003).

Due to the complexity and large variety of social issues, most of them being international, the regulation of corporate behaviour of MNEs has not been widespread. This lack of standardized international regulation on social and environmental issues allows managers to choose their own way of dealing with societal and environmental pressures, depending on various factors such as whether they see it as opportunities or inherent costs of doing business.

Even though the impact of MNEs on sustainable development is unclear, many international corporations subscribe to the triple bottom line and sustainable development. Yet it is not clear whether these activities are solely window dressing and management of public relations, or whether they are indeed strategic and affecting corporate performance (Kolk and Tulder, 2010).

According to Porter and Kramer (2006), of the 250 largest multinational corporations, 64% published CSR reports in 2005, either in their annual reports or separate sustainability reports. The fact that not most but more than a half publishes these reports mirrors the mixed and unclear results that such actions have on performance.

Rugman and Verbeke (1998a) acknowledge the study of corporate sustainability in the international context as highly valuable, as MNEs dominate industries that are pollution-intensive, such as petroleum, chemicals and heavy manufacturing. Arguably, corporations are the only organizations with the resources, technology and global reach to achieve sustainability. The main question is then whether the corporations have the motivation and incentives to do so, or, more precisely, under what circumstances and to what extent?

1.1. Research focus

This paper examines the extent to which sustainable development has been addressed in international business research and analyzes previous research results on the link between sustainable development strategies and financial performance.

Further international business theories such as transaction cost theory, the resource-based view and the institutional theory are integrated with the stakeholder perspective to form a theoretical framework that would allow for a better understanding for the link between sustainability practices and financial performance.

Kolk and Pinkse (2008) argue that current environmental and social challenges provide an opportunity in which existing international business theories can be tested, and from which new theoretical insights into the dynamics of the interaction between multinational enterprises (MNEs) and their international environment can be gained. The authors call for further research on the link between climate change and corporate performance. Although climate change is an important current issue, this paper incorporates other current issues in the concept of sustainable development to analyze its effect on performance.

This allows for the formulation of the two questions that this papers endeavours to answer:

Question 1: *To what extent do sustainability measures affect corporate performance of multinational corporations?*

Question 2: *Under what circumstances do sustainability measures affect corporate performance of multinational corporations?*

Although limited, there is some research on the link between the adoption of sustainable business practices by corporations. The international dimension, however, has not been thoroughly addressed in international business research (Kolk and Tulder, 2010).

To summarize, the central research question of this paper is to what extent and under what circumstances do sustainability measures affect corporate performance of multinational enterprises.

1.2. Structure of paper

This paper proceeds as follows. It begins with an introduction mentioning the importance of sustainable development in international business.

It continues with a clarification of the definitions and concepts that will be used further in the paper, as there is much confusion around the concepts of sustainable development and corporate sustainability.

Further, the relevant literature on corporate sustainability is reviewed and the main research directions are identified.

An analysis of the available empirical evidence on the relation between corporate sustainability and corporate performance follows, with the application of the relevant international business theories to the concept of corporate sustainability. Also, the international dimensions of corporate sustainability practices are discussed, such as international environmental regulations and the choice of a local or global environmental strategy. The attempt is made to integrate the insights drawn from the relevant international business theories into a framework in order to explain the results of previous empirical evidence and identify the factors that contribute to a positive effect of corporate sustainability to corporate financial performance.

Finally conclusions will be drawn and ways for international management to apply the developed framework will be discussed.

2. Literature overview and theoretical background

2.1. Definitions

The concept of a sustainable world dates back to the response of environmental damage caused by the industrial revolution of end of the 19th century. The broad concept of sustainability means the long-term maintenance of the world, including human and other life forms that live on it. Seen through the lens of our current economic or not so economic system of resource allocation and production, this concept has taken the form of what the World Commission on Environment and Development (1987) calls “sustainable development”, which, according to the commission, means “development that aims to meet human needs without compromising the ability of future generations to meet their own needs” (Clifton and Amran, 2011). Alternatively, as seen in Figure 1, sustainable development can be seen as the process to reaching the goal of sustainability (Baumgartner and Ebner, 2010).

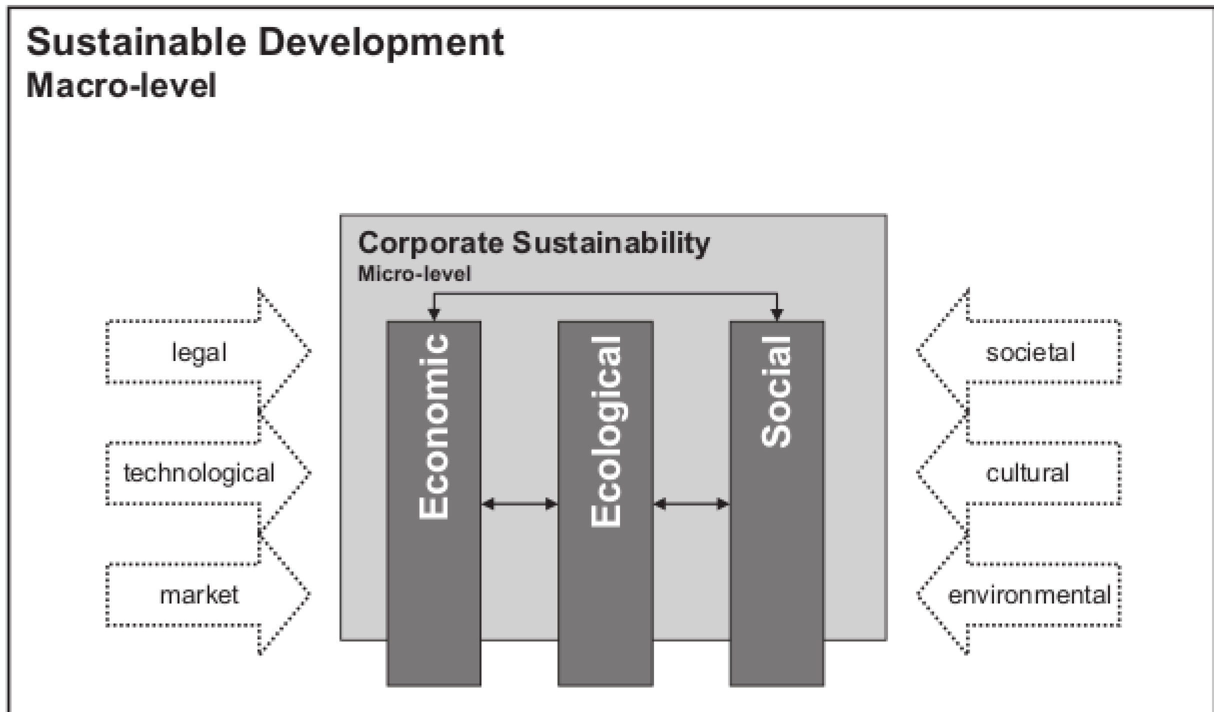

Figure 1: Corporate sustainability and its interdependences (source: Baumgartner and Ebner, 2010)

In terms of contribution of MNEs to sustainable development, their impact, both positive and negative, needs to be assessed not only in economic, but also in environmental and social terms. In order to capture the effects of this contribution, which some argue is one of the most influential from the possible contributions to sustainable development, we can use the concept of *corporate sustainability*.

This definition is similar to the one offered by the International Institute for Sustainable Development (IISD), where sustainable development from a business perspective is defined as "the adoption of business strategies and activities that meet the need of the enterprise and its stakeholders today while protecting, sustaining and enhancing the human and natural resources that will be needed in the future"[2]. This is the concept that will be used further in this paper.

[2] International Institute for Sustainable Development – Business Strategies for Sustainable Development, http://www.iisd.org/business/pdf/business_strategy.pdf; Accessed on Feb 20th, 2012.

Based on the definition of sustainable development, the organizational literature offers various definitions of sustainability in relation to organizations, which vary on the degree to which they classify corporate sustainability as mainly ecological, social or economic. A broad recognition of these three elements of corporate sustainability can be observed in the organizational literature, yet the relative salience and relationship varies (Linnenluecke and Griffiths, 2010).

There is much confusion regarding the difference between corporate sustainability and corporate social responsibility (CSR). Some scholars define CSR as an integration of the economic, social and environmental concerns into an organization's scope, yet others find clear differences between CSR and corporate sustainability. Wempe and Kaptein (2002, cited in Lo, 2009) argue that CSR is an intermediate step to the final goal of corporate sustainability. Van Marrewijk (2003) recommends keeping a small, but essential distinction between the two concepts: CSR has to be associated with the communication aspect of people and organizations (i.e. transparency, stakeholder dialogue and sustainability reporting), while CS has to be associated with the agency principle (i.e. value creation, environmental management, human capital management, etc.).

Lo (2009) adopted and modified the definitions of CSR and CS from Wempe and Kaptein (2002) and Linnanen and Panapanaan (2002) to construct a general model of corporate sustainability/corporate responsibility as shown in Figure 2.

Figure 2: General Model of Corporate Sustainability/Corporate Responsibility and Its Dimensions (source: Lo, 2009)

The question then arises if the three dimensions of corporate sustainability can receive the same weight when formulating strategies. Simple logic tells us that in order to exist in the first place, a corporation has to be profitable. If and only if it is profitable, and thus exists, can it address social and environmental issues that reaching the goal of sustainability requires. Thus we see that the economic dimension of corporate responsibility is primary, with the others secondary.

2.2. The main research directions

Although sustainability has received increasing attention in the past two decades, research on the topic of sustainable development and corporate sustainability can be called "embryonic", as there have been less than 3% of articles that referred to either corporate social responsibility or sustainable development in the mainstream management journals in the 1998-2008 period. While often mentioned as a relevant topic for international business and the study of MNEs, sustainable development has been mentioned only slightly more often in the international business journals than in the mainstream management ones (Kolk and Tulder, 2010). Reasons for this limited research area might include the lack of available data, as primary data collection on such a cross-border scale is expensive and time-consuming.

A major contribution to the literature on sustainability comes from Rugman and Verbeke, who published a series of papers (1998a, 1998b, 2000) attempting to link sustainability to internalization, competitiveness, public policy and MNE strategy (Kolk and Pinkse, 2008).

Currently, there are two main perspectives in the global scientific discourse on corporate sustainability. First, there are scholars (Friedman, 1970; Jensen, 2002; Levy, 1995) that oppose the concepts of corporate sustainability or corporate social responsibility. They argue that the only social responsibility of business is to maximize wealth. On the other hand, there are management scholars (Porter and van der Linde, 1995; Porter and Kramer, 2006; Kolk and Pinkse, 2008) that argue that adoption of corporate sustainability practices will lead to improved financial

performance. This perspective is seen as the “business case” for sustainability. Further, both perspectives will be discussed in detail.

2.2.1. The social responsibility of business is profit

The view that the primary goal of business is to increase profit has been promoted by Milton Friedman in his 1970 paper called “The Social Responsibility of Business is to Increase its Profits”. Friedman argues that as corporate executive, the manager’s primary responsibility is to the owners of the corporation, as he is acting as their agent representing their interests. As long as the actions of the corporate executive or manager reduce the returns to shareholders, he is spending their money. Based on these arguments, Friedman concludes that “there is one and only one social responsibility – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say engages in open and free competition without deception or fraud” (Friedman, 1970, p.6). It is important to note that Friedman’s position does not exclude the possibility of adopting sustainability practices that are expected to increase the returns to shareholders. So, this view of the firm does not directly come into conflict with the business case for sustainability. Also, it implies that governments are fully responsible for regulating corporate behaviour. This implication, however, leads to complexity in the case of MNEs, as they operate across borders in countries with heterogeneous legal environments.

A second argument in favour of this view is that even in the case where there are international commitments to address sustainability pressures, there is no administrative support to ensure global compliance (Escobar and Vredenburg, 2011).

Margolis and Walsh (2003) refer to Milton Friedman's arguments as part of the contractarian view of the firm, or, to be more exact, the economic version of contractarianism. This view opposes the corporate responses to social misery and can be expressed in three forms:

- Firms already advance social welfare to the full extent possible. According to Jensen (2002), there are “200 years’ worth of work in economics and finance” that show that social welfare is maximized when firms maximize their value. He argues that firms cannot maximize value along multiple dimensions, and thinks that focusing on the shareholder-value maximization dimension ensures the other dimensions (i.e. social) are maximized as well.

- The only legitimate actors to address social concern are elected governments. This argument mirrors Milton Friedman’s view that it is not the responsibility of corporations to ensure that social welfare is secured, but rather the responsibility of the government. Hence the corporate social responsibility can be termed in this case governmental social responsibility.

- If firms do get involved, managers must warn their constituencies (i.e. shareholders) so they can protect themselves from bad managerial decisions. Even if corporate social initiatives are taken, as long as they are disclosed and shareholders are warned, they are unobjectionable.

Considering these arguments, the challenge is to find ways to promote social justice and environmental responsibility in an economic system dominated by shareholder wealth maximization (Margolis and Walsh, 2003). The practical attempts to link corporate sustainability to increased financial performance by organizational scholars have been paralleled by the emergence of the stakeholder perspective, which will be discussed later in this paper.

2.2.2. The business case for corporate sustainability

For the last two decades, the business case for sustainability has received more and more attention from the academic community as well as the corporate sector. The view that corporations, by responding to stakeholder pressures, might gain competitive advantage is termed “the business case for sustainability”. The notion of “the business case” has been increasingly used by environmental organizations, governments and the corporate sector to justify the need for adoption of corporate sustainability strategies within organizations (Salzmann et al., 2005).

This perspective assumes that organizations are responsive to sustainable development pressures not because of coercive forces such as government regulation or industry pressures, but because there are financial, as well as social benefits in doing so (Escobar and Vredenburg, 2011).

Economically, there are two ways corporations can benefit from adopting corporate sustainability practices. On the cost side, there are potential reductions in operating expenses from an increase in efficiency, a better use of resources or innovation in production technology. On the revenue side, firms can develop competitive advantage through environmental management and enter the green market niches (Valentine, 2010).

Another reason to manage social and environmental pressures is the threat of creating a negative company image by various interest groups. The failure to address these pressures might prove to be a major cost in terms of lost customers and revenue.

Rugman and Verbeke (1998a) developed a framework, according to which firms will commit resources to improve environmental performance only if they will lead to the creation of “green” firm-specific advantages (FSAs). Depending on the level of *flexibility* and *leveraging potential* of resource commitments for environmental performance, one can estimate whether firms will commit resources to the improvement of environmental performance. The level of flexibility indicates whether the resources are reversible to be used otherwise in case they do not create “green” FSAs, and the level of leveraging potential indicates the extent to which they contribute to improving environmental performance. Consequently, firms are likely to adopt sustainable practices when the level of both flexibility and leveraging potential is high. Aside from FSA, environmental regulations can change the country-specific advantages for specific countries. The challenge for MNEs is that they have to adapt their FSA to the CSA that they operate in, thus finding the optimal configuration (Kolk and Pinkse, 2008).

The prevailing view, according to Porter and van der Linde (1995), is that there is an evident trade-off between the ecological and social benefits for society on one hand and the economic wealth maximization on the other. The authors note the dynamic nature of competition, arguing that companies will find innovative solutions to pressures from environmental regulations, which will cause a more efficient use of raw materials and thus enhanced resource productivity, which will make companies more competitive.

The “business case” tries to show that corporate attention to social concerns is compatible with maximizing shareholder wealth. Yet, it is evident that this is not always the case, otherwise there would be no social misery or environmental degradation from industrial production. The question then arises: is corporate sustainability a trade-off or a win-win situation? Are win-win situations that spring from the adoption of corporate sustainability the rule, or are they exceptions from the rule?

Even if the win-win paradigm leads to increased social and environmental performance, it is only to the extent that this fact has a positive influence on financial performance. Thus, it follows that, after all, the business case is also pure pursuit of economic profit. Hahn et al. (2010) argues that the win-win paradigm limits the scope of potential corporate contributions to sustainable development. By following this paradigm, firms will only contribute to sustainable development if they have an economic interest, and fail to do so in all other cases. It will systematically exclude potential corporate contributions to sustainable developments if they are “outside the win-win optic”. Given the complexity of and diversity of issues related to sustainable development, the authors argue that trade-offs and conflicts in corporate sustainability are the rule rather than the exception.

Two approaches to reaching the goal of a sustainable world can be identified in the sustainability literature (Clifton and Amran, 2011):

- The reformist approach supports the view that the current infinite growth paradigm is capable of addressing and solving the inefficiencies and inequalities of the economic system. Increasing globalization and

technological development are expected to improve resource efficiency and reduce pollution. Multinational corporations as increasingly influential actors on the international scene are expected to take the lead in promoting sustainable business.

- The transformational approach views the economic system as the root cause of inefficiencies and unsustainable behaviours. The incentives promoted by this system come into direct conflict with those of a sustainable world. The agency theory and the property rights approach have been used to describe the underlying incentives promoted by the current system. According to this view, the alignment of corporate incentives for growth and value maximization with the generally consented need of a sustainable world can only be accomplished by a transformational change.

In line with the arguments for a business case for corporate sustainability, Sarkar (2008) argues that the role of environmental responsibility has evolved from environmental management to environmental strategy, pointing out a closer fit between a company's strategy and CSR (Babiak and Trendafilova, 2011).

2.3. The relationship between corporate sustainability and financial performance

How do companies that are considered sustainable perform in comparison to the rest? Is there any evidence demonstrating that the adoption of sustainable business practices by a company outperforms companies conforming to the contractarian view?

Launched in 1999, Dow Jones Sustainability Indexes are the first global indexes tracking the financial performance of leading sustainability-driven companies worldwide. Figure 3 shows the performance of the Dow Jones Sustainability World Index (DJSWI) in comparison with the Morgan Stanley Capital International World Index (MSCI) measured in total return. There is no clearly visible difference between

the performances of the indices. During the first years from launch until around the year 2006 the DJSWI slightly underperformed the MSCI. The opposite seems true for the last half of the decade. Of course, there are limitations to this comparison. For example, the performance might vary depending on how the index components are weighted and how the dividends are accounted for.

Cerin and Dobers (2001) argue that although the DJSGI is committed to addressing environmental, social and economic concerns, the superior performance of their listed corporations is directly related to their commitment to the following five corporate sustainability principles:

- Innovative technology;
- Corporate governance, which includes corporate culture, organizational capability and stakeholder relations;
- Shareholder relations;
- Industrial leadership and
- Social well-being.

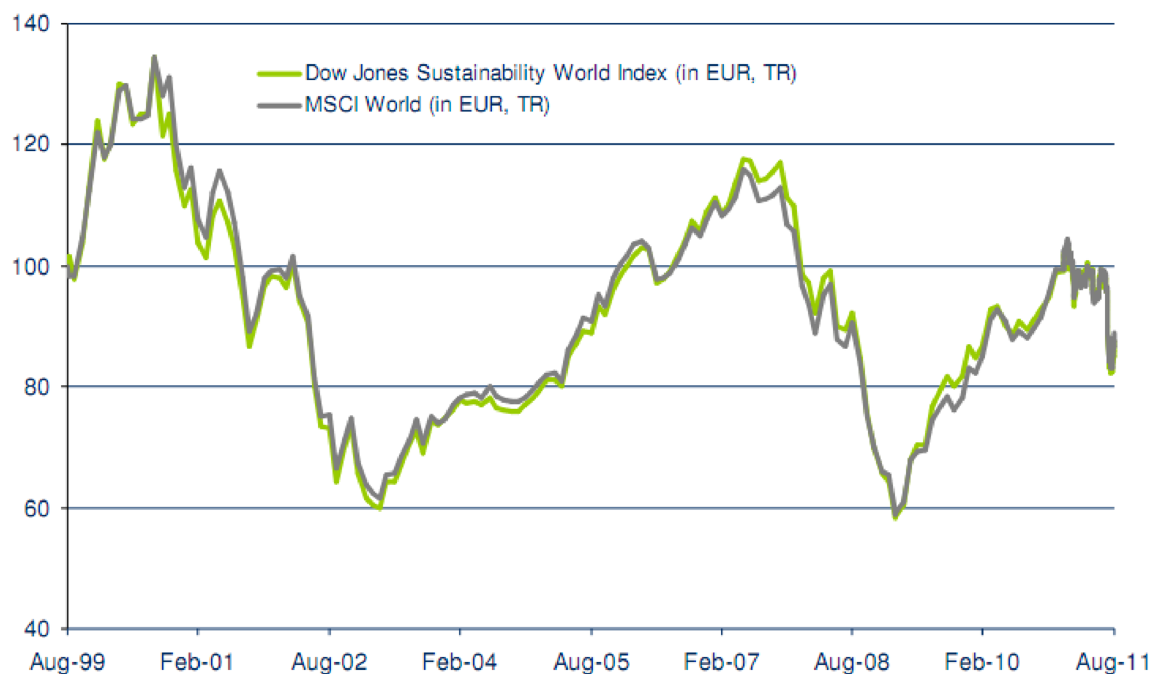

Figure 3: Dow Jones Sustainability World Index versus Morgan Stanley Capital International (source: www.sustainability-index.com)

On another note, Figure 4 shows the performances of Dow Jones Sustainability Europe 40 Index (DJSE40) in comparison to STOXX Europe 50, also measured in total return. In this graph, it is evident that the European companies, listed in the DJSE40 index, clearly outperform those that are not listed.

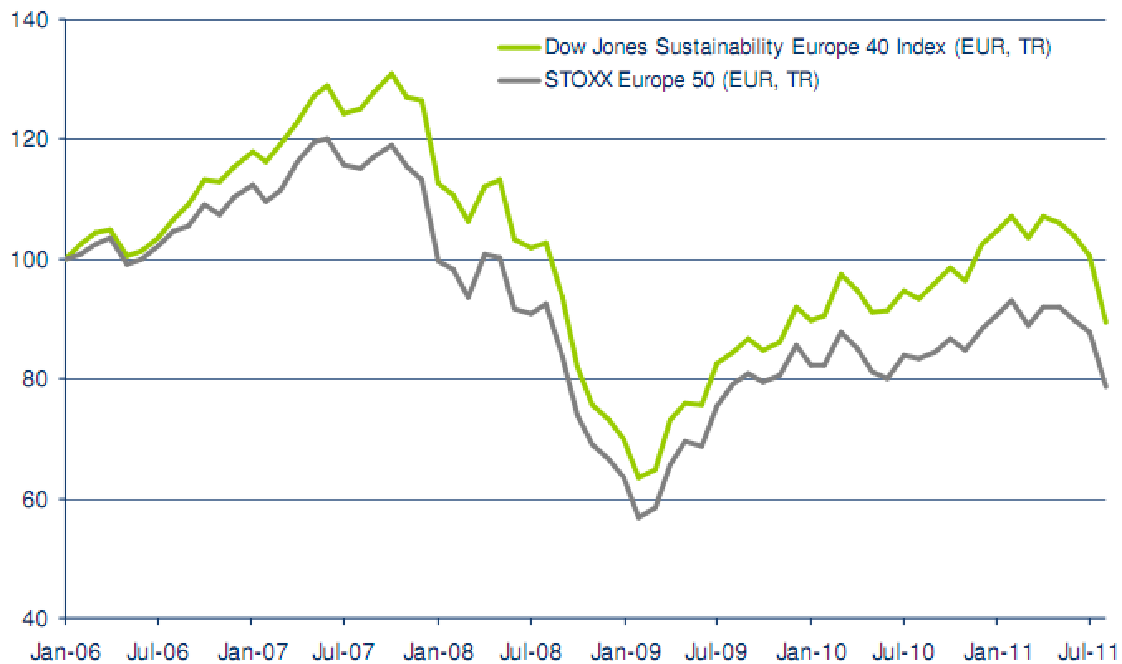

Figure 4: Dow Jones Sustainability Europe 40 Index versus STOXX Europe 50 (source: www.sustainability-index.com)

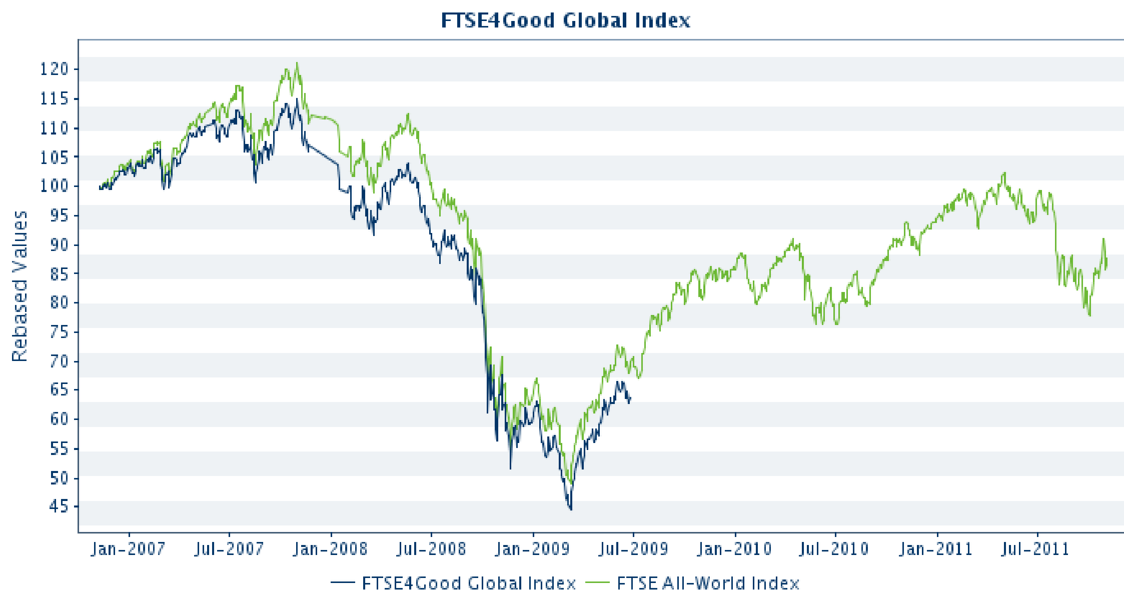

Figure 5: A five-year financial performance comparison between FTSE4Good Global and FTSE All-World Indices (source: www.ftse.com)

In 2001, the Financial Times Stock Exchange (FTSE) Group launched their own index, called FTSE4Good, to objectively measure the performance of companies that meet globally recognised corporate responsibility standards. As seen in figure 5, the FTSE4Good underperformed the FTSE All-World index.

Margolis and Walsh (2003) covered a thirty year period (from 1972 to 2002) of 127 published studies that examined the relationship between companies' socially responsible behaviour and their financial performance. In 109 of the 127 studies, corporate social performance was the independent variable. 54 of the studies found a positive relationship, 7 studies found a negative relationship and 28 reported non-significant relationship. A mixed relationship was identified in 20 studies. When treating financial performance as the independent variable, the majority of studies pointed to a positive relationship, meaning that a company performing good financially will tend to have a good social performance as well. These results point to a clear conclusion: there is significant evidence that social and financial performances are positively correlated and little evidence that they are negatively correlated.

Orlitzky et al. (2003) report similar findings in a meta-analysis of 52 studies yielding a total sample size of 33,878 observations. Their findings suggest that social responsibility and, to a lesser extent, environmental responsibility are positively associated with financial performance. The relationship tends to be simultaneous and bidirectional.

One might assume that the inclusion of a company in a sustainable index will affect its price. Curran and Moran (2007) examined whether public announcements of adherence to environmental and social standards by publicly traded companies would influence their corporate performance. They found that, while there are positive and negative effects on the daily returns, the changes in stock prices are not significant and the data does not suggest that the inclusion in the FTSE4Good UK index has a long-term influence on the financial returns. Consequently, this means that if a company listed in an index that endorses environmental and social

performance shows better financial performance, this is not due to investor actions, but rather internal operations.

Salzmann et al. (2005) summarized and assessed existing research on the "business case" for sustainability. The scientific studies have been divided into theoretical frameworks and empirical studies. Regarding qualitative case studies, the authors argue that they are usually dominated by successful pollution prevention stories and cost savings in price-sensitive sectors such as petroleum or chemicals. The two drawbacks of case studies are that they are based on qualitative data which doesn't count as hard enough evidence, and second that they are industry, sector or country specific. Furthermore, the results of portfolio analyses are considered ambiguous and dependent on factors such as weighting of the portfolio, time period and risk adjustment.

According to the authors, the issue of the CSP-CFP remains unresolved, as the results of instrumental studies suggest that the relationship is complex and depends on situational and company-specific factors. However, the results of meta-analyses such as that done by Orlitzky et al. (2003) lead us to the assumption that corporate sustainability leads to increased financial performance, but only under certain circumstances and to a certain extent. What are the dimensions of this relationship and their relative influence? To what extent can corporate sustainable practices influence the financial performance? The attempt will be made to answer these questions using a framework that integrates the relevant theories and the results of previous instrumental studies.

2.4. The relevant theoretical background

There are three important bodies of literature that can offer relevant insights to help move the analysis in a theoretically oriented direction. Different theories of the firm can help us understand different aspects of its nature and purpose. For example, the stakeholder theory offers an alternative to understanding the way in which different actors operate and interact with a corporation. It examines whether and why

corporations address interests and claims of stakeholders along with their own corporate interests (Campbell, 2007).

The institutional theory explains how guidelines, structures and norms affect corporate behaviour. The resource-based view is used to define the capabilities of a firm in order to gain competitive advantage. Further each of these theories will be examined and used to explain under which circumstances multinational corporations achieve an improved financial performance by adopting sustainable business practices.

2.4.1. The stakeholder theory

Due to the fact that the firm interacts and builds dependencies with actors other than shareholders, some scholars have challenged the primacy of shareholders as the only beneficiaries of a firm, arguing for a stakeholder theory that encompasses the various internal or external groups with their interests and responsibilities.

The stakeholder theory has been substantiated by Edward Freeman in his 1984 book "Strategic Management: A Stakeholder Approach". According to this theory, corporations have responsibilities to shareholders and to other groups, which are identified as stakeholders of the corporation. The theory tries to establish a legitimate role for groups other than the shareholders whose interests can influence the manager's actions and decisions.

As defined by Freeman (1984, page 33), the concept of 'stakeholder' includes any group that is affected or can affect the achievement of the company's objectives. The various stakeholder groups are seen as ends in themselves and not just means to maximize the returns to shareholders.

It is a subject of debate in the stakeholder literature which groups qualify as stakeholders. However, two main themes have emerged: the narrow view and the broad view.

The narrow view encompasses groups that are directly relevant to the corporation's economic interests and without whose ongoing input the corporation would not survive. Examples of these groups are shareholders, customers, local communities, employees and creditors (Clifton and Amran, 2011).

The broad view is in line with Freeman's definition of stakeholder, which encompasses any group that is affected or can affect the achievement of an organization's objectives.

Even if the stakeholder literature goes to great lengths in promoting the interests of other groups than shareholder, it is still important for managers to narrow and prioritize the stakeholders whose interests they promote due to conflicting interests, resource scarcity and complexity of maximizing parallel returns (Clifton and Amran, 2011).

Regarding sustainability, Clifton and Amran (2011) find the stakeholder approach to be, in many ways, inconsistent with what it means for there to be a sustainable world. The narrow view limits the groups that managers are supposed to consider, while in a sustainable world all the groups impacted by a corporation's operations are important. The broad view comes closer to the objectives of a sustainable world, but again it fails to consider stakeholders that are not beneficiaries and thus treats them unjustly.

Mitchell et al. (1997) classified stakeholder based on 3 attributes: power, legitimacy and urgency (Figure 6). Power is defined as "a relationship between social actors in which social actor A can get social actor B to do something that B would not have otherwise done" (Mitchell et al., 1997, p.865). According to the same author, legitimacy is "the assumption that the actions of a stakeholder are appropriate, proper or desirable within their relationship with the corporation" and urgency is "the degree to which stakeholder claims call for attention".

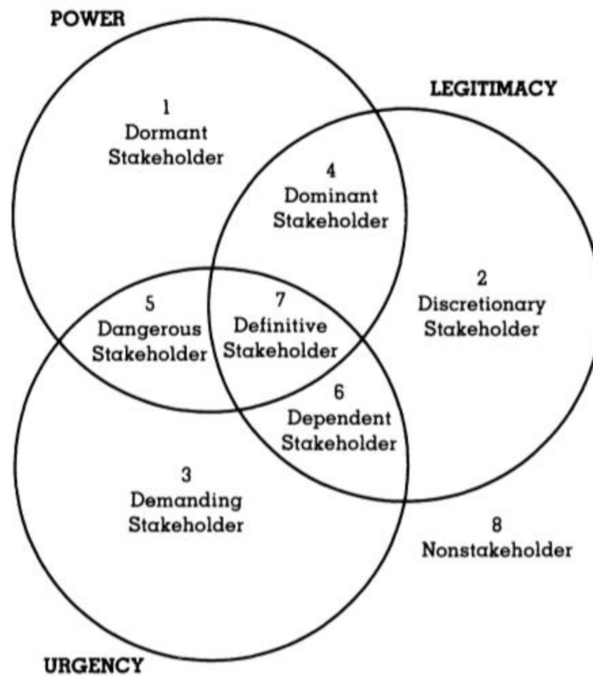

Figure 6: Stakeholder classification by possession of attributes (Source: Mitchell et al., 1997, p. 874)

According to Mitchell et al. (1997), latent stakeholders possess only one of the three attributes. Thus, they can either be demanding, discretionary or dormant. Those possessing two attributes at the same time are called expectant stakeholders. They can be dangerous, dominant or dependent. If there are stakeholder groups that possess all three attributes, they are called definitive. Based on this classification, managers can categorize claims based on their priority to the corporation and choose the strategies that best attend to them. In this model, stakeholder salience is in a direct and positive relationship with the cumulative effect of the three stakeholder attributes (Buysse and Verbeke, 2003). It is important to note that the possession of the attributes described by Mitchell et al. (1997) is of a dynamic nature, and managers should adjust the associated priorities of stakeholder groups over time.

Another categorization comes from Banerjee and Bonnefous (2011), who classify stakeholders based on their acceptance of or opposition to the corporation's operations. In the nuclear energy industry, supportive stakeholders are governments and international institutions that support nuclear energy development. Obstructive

stakeholders are in direct opposition to the corporation's objectives. The passive stakeholder group includes the general public that does not have a clear opinion about the objectives of the company.

In order to clarify the confusion regarding the nature and purpose of the stakeholder theory, Donaldson and Preston (1995) present the three types or aspects of stakeholder theory: descriptive, instrumental and normative. The theory is *descriptive* because it is used to describe and explain corporate behaviours and characteristics. Towards this end, the theory has been used to explain how managers prioritize the interests of corporate constituencies, the nature of the firm and how corporations are in fact managed. In other words, it explains to what extent managers do in fact address stakeholder demands and act in accord with their interests. The *instrumental* stakeholder theory is used to connect the achievement of corporate objectives in the form of economic benefits with stakeholder management. Results from instrumental studies suggest that addressing stakeholder demands leads to a better corporate performance than alternative approaches. The *normative* stakeholder theory prescribes moral and philosophical guidelines for the management and operations of corporations. It explores whether managers should address other stakeholder claims than those of shareholders and whether these claims are justifiable (Margolis and Walsh, 2003).

Figure 7 offers a visualization of the three perspectives of the stakeholder theory as described by Donaldson and Preston (1995). The theory starts by describing observed relationships from the external world; hence the external level is the descriptive aspect. At the next level, its descriptive accuracy has to be challenged and supported by the instrumental aspect. Only then becomes the theory normative in the sense that it prescribes a certain practice in order to achieve the desired objective.

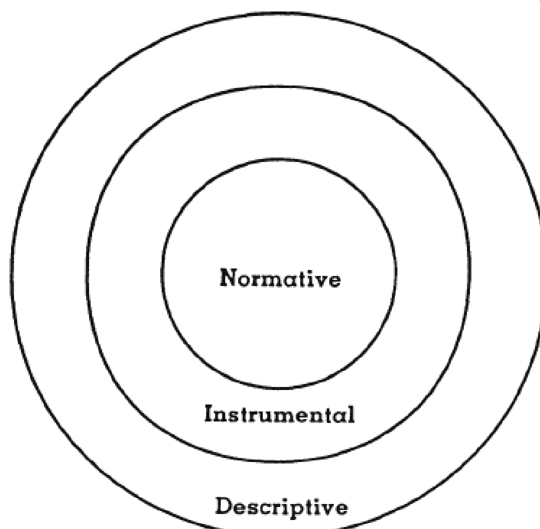

Figure 7: The three aspects of stakeholder theory (Source: Donaldson and Preston, 1995)

Buysse and Verbeke (2003) differentiate between two broad branches in the stakeholder theory literature: a *strategic* and a *moral* branch. The strategic literature focuses on the management of stakeholder interests, while the moral tries to balance the interests of various stakeholder groups. The strategic literature categorizes stakeholders into primary and secondary. The primary stakeholders are the ones that are engaged in formal relationships with the organization (i.e. employees, suppliers, customers). The secondary stakeholders, on the other hand, include actors that are not engaged in formal relationships with the firm, such as media and other interest groups.

According to Donaldson and Preston (1995), many instrumental studies of corporate social responsibility suggest that by adhering to stakeholder principles and practices, corporations will be able to achieve their corporate performance objectives as well or better than other approaches. It must follow then, that by addressing and respecting claims of *definitive* stakeholders as defined by Mitchell et al. (1997), companies can expect a better performance in comparison to other approaches. This papers interest is in finding the circumstances, under which sustainability measures affect corporate performance. Thus, following this train of thought, it is clear that sustainability measures are more likely to affect corporate performance when the definitive stakeholders of a company have a higher affinity to corporate sustainability. By

addressing their claims, corporations will then be more likely to achieve their corporate performance objectives.

2.4.2. The institutional theory

In order to understand the link between sustainable business practices and financial performance, it is important to consider the motivations for adopting them.

In the international business literature, Kolk and Tulder (2010) note an increased interest in institutions in the past few years. Applied to corporate sustainability, the institutional theory of the organization can help us understand why some organizations, especially multinational corporations, adopt a high level of commitment to corporate sustainability and others a low level or no engagement at all.

What are institutions? A commonly used definition is that of Scott (1995, cited in Peng et al., 2008), who defines institutions as “regulative, normative, and cognitive structures and activities that provide stability and meaning to social behaviour”. Examples of institutions are society with its ethical norms, law and the regulatory regime or industry with generally accepted norms and rules of business. Institutional theory, therefore, explains why organizations behave similarly when operating within similar social frameworks of norms, values and assumptions (Darnall, 2008).

Applied to organizations, the institutional theory is especially important when analyzing the behaviour and strategy of multinational enterprises as the institutional settings differ very much across borders. Institutional theorists (DiMaggio and Powell, 1983; Campbell, 2007) have argued that several institutional forces influence the level to which a company might adopt corporate sustainability. These institutional forces may lead to homogenization of institutional settings and thus to increasingly standardized sustainable business practices across industries (Babiak and Trendafilova, 2011; Campbell, 2007).

An important concept in institutional theory is that of *legitimacy*, which has been defined by Suchman (1995, cited in Babiak and Trendafilova, 2011, p.12) as the "generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions". The pursuit of legitimacy in the eyes of various stakeholders might lead organizations to consider adopting corporate sustainable practices, even if they negatively influence the short-term profitability. This link to legitimacy is, as Babiak and Trendafilova argue, the reason why the institutional theory can be used to explore the CSR and sustainable business practices.

According to Babiak and Trendafilova (2011), the main motives for engaging in corporate sustainability can be divided in two categories: those of a moral concern and those associated with strategic objectives. Through the lens of stakeholder theory, the moral concern can be seen as a subset of the strategic concern, as it serves to address stakeholder (i.e. investors' or customers' green commitment) claims in order to successfully manage stakeholder risk. Environmental responsibility has been found to be the most important claim of stakeholders in a company's CSR practices (Welford et al., 2007, cited in Babiak and Trendafilova, 2011). The results of the survey indicate that executives responsible for decision-making regarding sustainable management practices in the sport industry perceived the pursuit of legitimacy by conforming to institutional pressures and the advantage of strategic opportunities as the primary motives for engaging in environmental CSR.

Seen through the lens of institutional theory, the two groups of factors that might lead to competitive advantage are internal efficiency and external legitimacy.

DiMaggio and Powell (1983) identify three mechanisms through which institutional change occurs: coercive, normative and mimetic isomorphism. *Coercive isomorphism* stems from governmental regulation. In the case of MNEs, it comes from enforceable international regulations and agreements (2011 Escobar and Vredenburg). *Normative isomorphism* comes from professionalization, which is interpreted as the "collective struggle of members of an occupation to define the conditions and methods of their work" (DiMaggio and Powell, 1983, p. 152).

Normative isomorphism usually occurs at industry-level in order to prevent stringent governmental regulations that could put at risk the competitiveness of an organization. *Mimetic isomorphism* happens when organizations imitate and adopt proven strategies and practices in order to avoid the risk that comes from uncertainty and complexity of new strategies.

Campbell (2007) puts forward an institutional theory of corporate social responsibility, which explores the broad set of institutional settings under which socially responsible corporate behaviour might occur. Although institutions such as state regulations and business associations can help mitigate socially irresponsible corporate behaviour, they can also create opportunities for corporations to engage in other forms of opportunistic behaviour, especially by influencing governmental decisions. However, there are still cases of corporations choosing to act responsibly, even if they have the chance to act opportunistically. In the increasingly global economic environment and due to the lack of standardized regulation, multinational corporations find themselves in conditions that allow for opportunistic behaviour.

According to Campbell (2007), the relationship between socially responsible corporate behaviour and economic conditions is mediated by various institutional factors such as dialogues among corporations and their stakeholders, private and public regulation and the presence and influence of non-governmental organizations and other independent organizations that monitor corporate behaviour. It’s important to note that Campbell only focuses on the institutional settings in which the firm operates, leaving determinants of socially responsible corporate behaviour that operate at the firm level out of his analysis.

Further, Campbell (2007) forwards two propositions that show the effect of economic conditions on socially responsible corporate behaviour. The first proposition, known as the *slack resource theory*, states that in an unhealthy economic environment, where the potential for short-term profit is limited corporations are less likely to behave socially responsible. The second proposition, which is a subset of the first one, states that the probability of socially responsible corporate behaviour is inversely related to the level of competition of the corporation, as profit margins are

lower and thus managers have to save money wherever possible. On the other extreme, as Campbell argues, the likelihood of corporations behaving in socially irresponsible ways increases when there is virtually no competition (i.e. monopoly). This is because customers have no other alternative and thus corporate behaviour will have no or little influence on sales.

One of the most important institutions that influence the level of socially responsible corporate behaviour is governmental regulation. For example, the financial crisis that started in the United States in 2008 has been attributed in large part to the lack of regulation of financial instruments such as derivatives or credit default swaps (Crotty, 2008). However, it is important to understand the reason for the lack of regulation. Especially in developing economies, the government fear the loss of foreign direct investment, production, jobs and tax revenues, and thus see themselves forced to lessen economic regulations, which directly affect the readiness of corporations to act responsibly.

Following the arguments of institutional factors influencing social corporate responsibility, the author proposes that given the presence of the following institutional settings, corporations will be more likely to act in socially responsible ways:

- Strong and well enforced state regulation, particularly if they were developed through negotiation among government, corporations and other relevant stakeholders
- Well-organized and effective industrial self-regulation, especially if it is based on the threat of state intervention
- The presence of independent organizations, including NGOs, institutional investors, social movement organizations and the press to monitor and influence corporate behaviour
- The presence of business publications, business school curricula or other educational venues that call for socially responsible behaviour
- Membership in trade or employer associations, but only if they promote socially responsible behaviour

- Institutionalized dialogue with employees, unions, investors, community groups and other relevant stakeholders (Campbell, 2007).

Even if corporations are more likely to act in socially responsible ways under the above mentioned conditions, the question remains under which circumstances in regards to institutional pressures their sustainable practices will influence their financial performance.

2.4.3. The resource-based view

The resource-based view argues that at the core of competitive advantage lie the disparities in resources and capabilities. If we look at the organization as made of resources and capabilities that can be configured and reconfigured in order to gain competitive advantage, then the resource-based view provides us with an internal tool that helps determine strategic choices.

Resources can be seen as available inputs that enable an organization to carry out its activities (Henry, 2008). In and of themselves, resources add no value to organizations. It is only when they are used in a productive way that they have the potential to add to competitive advantage.

Capabilities are capacities to use and deploy the available resources in a configuration towards a desired end (Christmann, 2000). It is thus safe to assume that in an industry, organizations will have similar access to resources, yet the way the use those resources has the potential to advance their competitive advantage.

Aside from the firm-specific resources, there are country specific resources and capabilities. However, unlike firm-specific resources and capabilities, the country-specific ones cannot be configured, but rather an optimal configuration of firm- and country-specific resources and capabilities should be found.

Applied to corporate sustainability, the resource-based view implies that by addressing sustainable development pressures, MNEs could create a new source competitive advantage through increasing efficiencies, opening new markets or

reducing pollution. For example, organizations with fewer internal resources and capabilities may not be able to respond as quickly or as effectively to different types of institutional pressures, whereas facilities with stronger resources and capabilities may be able to do so.

Litz (1996) argues that, instead of social and environmental dimensions as bothersome obstacles on the path to profitability, managers should recognize the potential in the development of necessary and enduring sources of competitive advantage. The author presents a three-stage model of adaptive behaviour, which integrates stakeholder interdependence, ethical reflection and issues management with the resource-based-view in order to provide a richer perspective on the nature of resource-based competition. In so doing, he supplements the resource-based view with stakeholder consideration, ethical reflection and responsive action in order to encourage the formation of distinctive capabilities and thus another source for competitive advantage.

This argument is supported by Branco and Rodrigues (2006), who contend that from the resource-based perspective, corporate sustainability internal or external benefits, or both. The internal benefits might comprise the development of capabilities related to know-how and corporate culture, which would lead to the creation of intangible resources such as those associated to employees. Under external benefits can be considered corporate reputation, which is also an intangible resource that arises from engaging in social responsible activities. Corporate reputation can be used to attract qualified employees, increase and maintain their motivation and loyalty to the firm.

In contrast, Henry (2008) argues that resources, per se, do not confer any benefit to organizations. It is only when they are efficiently configured, that they provide the organization with competencies. Yet, seen this way, every organization has competencies. In order to achieve sustainable competitive advantage, an organization has to have a continuous process of *distinctive capabilities or core competencies* development.

Capabilities can be either tangible or intangible. Tangible capabilities are easy to copy or replace and are tradable. Therefore, they are not a source of sustainable competitive advantage. Tangible resources can be categorized as physical, financial and human resources (Henry, 2008). Intangible capabilities, on the other hand, are difficult to copy and replace, as they are a function of time invested in developing them, reliance on other firm-specific capabilities and their integration with other core capabilities (Escobar and Vredenburg, 2011). Examples of capabilities include intellectual and technological resources and reputation. Corporate sustainability measures (in the case when they contribute to a good reputation) can be seen as intangible capabilities, so they cannot be acquired on the market and have to be developed within the firm. As such, they are likely to be a source of sustainable competitive advantage.

According to Rugman and Verbeke (1998a), resources will be committed to environmental activities only if they will lead to the creation of firm-specific advantages. In the international milieu, country specific advantages are also worth considering. These are the advantages that are country-specific, such as environmental regulations. The optimal configuration of firm and country specific advantages has to be found, which means altering firm-specific advantages.

Given the presence of complementary resources and capabilities, MNEs will incur lower adoptions costs of environmental management systems and require relatively less corporate sustainability-related resources and capabilities. At the same time, organizations with stronger internal capabilities will rely on external resources, such as government assistance or consultant expertise, to a lesser extent. Capabilities are considered complementary to CSR and corporate sustainability if they facilitate the adoption process (Darnall and Edwards, 2006). For example, an organization’s quality control management systems may assist with the development and implementation of advanced environmental management systems (Hart, 1995 cited in Darnall and Edwards, 2006).

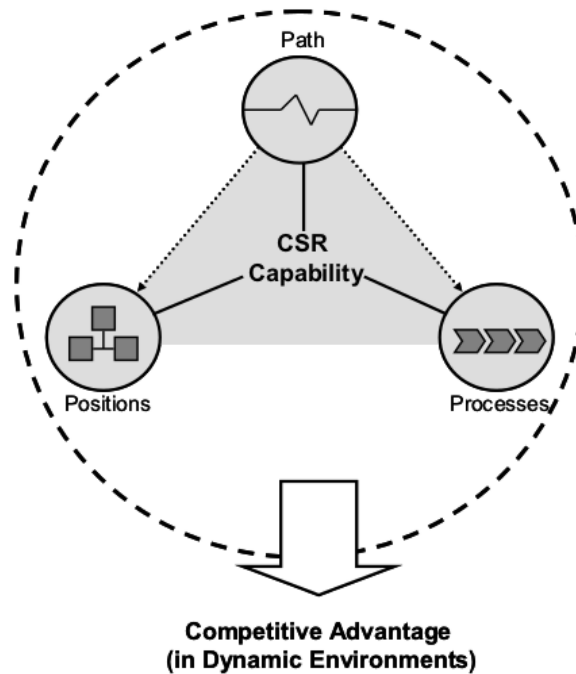

Figure 8: CSR as dynamic capability (source: Lattemann et al., 2007)

Lattemann et al. (2007) identify CSR as a dynamic capability, to be used by firms in order to gain competitive advantage in a dynamic environment (figure 8). Although CSR does not necessarily lead to competitive advantage, such capabilities are of crucial importance towards that goal. CSR activities are used to embed stakeholders into the firm's processes, so that stakeholder dialogue is seen as a CSR activity. Five organizational processes can be identified in regards to CSR: stakeholder management, accountability, ethics, value-attuned public relations and stakeholder dialogue. Furthermore, a firm's strategic position can be influenced by CSR activities, which have an impact on the firm's reputation. CSR activities also influence the development of a firm, which is a function of current position and its path. Thus, CSR is in position to affect the configuration of firms resources and capabilities and thus indirectly influence the firms performance.

3. Corporate sustainability in the international context

3.1. International environmental regulations

Environmental issues and attempts to regulate them on national, regional and international levels have come to the forefront of public policy agendas in the past few decades. However, the impact of international regulation on the activity of MNEs has not seen much research and insights can be drawn only from few specialized publications.

Due to many environmental challenges facing our increasingly globalized society, the need for international cooperation and regional integration, the international corporate sector has seen increased environmental regulation.

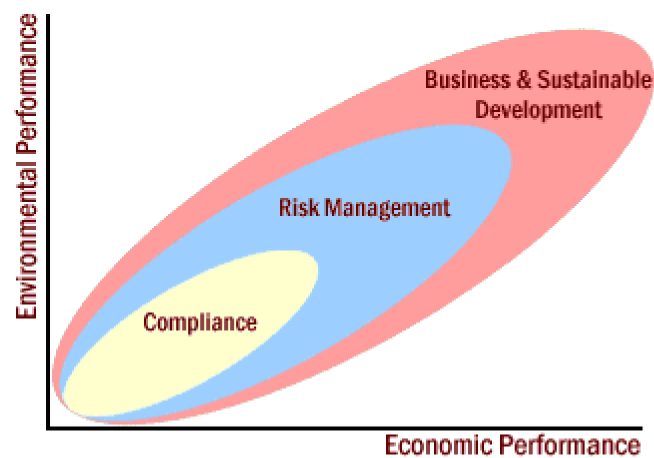

Figure 9: The sustainable development journey (source: International Institute for Sustainable Development)

According to the International Institute for Sustainable Development, there is a three-stage journey from environmental compliance, through environmental risk management to long-term sustainable development.

Figure 9 shows that in the initial phase, there is a need to comply with environmental regulations. MNEs are expected to invest in restructuring their activities so as to

comply with the newly introduced regulation. Therefore, their economic performance suffers, as there are unexpected costs that threaten profitability. However, as some MNEs choose to go over compliance and embrace environmental programmes towards the goal of sustainable development, they learn to anticipate environmental liabilities and take on a proactive rather than reactive approach. Thus, environmental costs may be turned into opportunities, under certain internal and external circumstances. Environmental risk management allows them to anticipate and minimize risk and prevent environmental hazards (i.e. pollution control turns into pollution prevention). This approach saves corporations money by anticipating and avoiding expenditures linked to environmental damage, and by minimizing the cost of complying with future regulations. The final stage in the journey is the development of sustainable business practices and programmes, which are thoroughly integrated into corporate strategy. The number of “win-win” type of situations is maximized, and the cost of complying with legislation is minimized through complex anticipation programmes.

As the firm goes through the steps towards sustainable business development, the costs associated with environmental compliance have the potential to become opportunities, and the firm acquires the skills to mitigate risk associated with environmental performance.

As shown in Figure 10, the corporate compliance with international environmental policies can be categorized based on the expected economic benefits (high or low) and based on whether there are benefits driven by expected improvements in industrial performance or whether there are sanctions associated with non-compliance (Rugman and Verbeke, 2009). In the first quadrant, international environmental regulation is welcomed, as the economic benefits from complying to them are high. The second quadrant reflects the case where there is no administrative enforcement of environmental legislation and the benefits from complying are low, which leads to a response of unconditional non-compliance. In the third quadrant, compliance is enforcement-driven and the main motive is the avoidance of costly sanctions. The final quadrant reflects the case where there is

administrative enforcement, but low net economic benefits, which would evoke a response of conditional non-compliance from the firm.

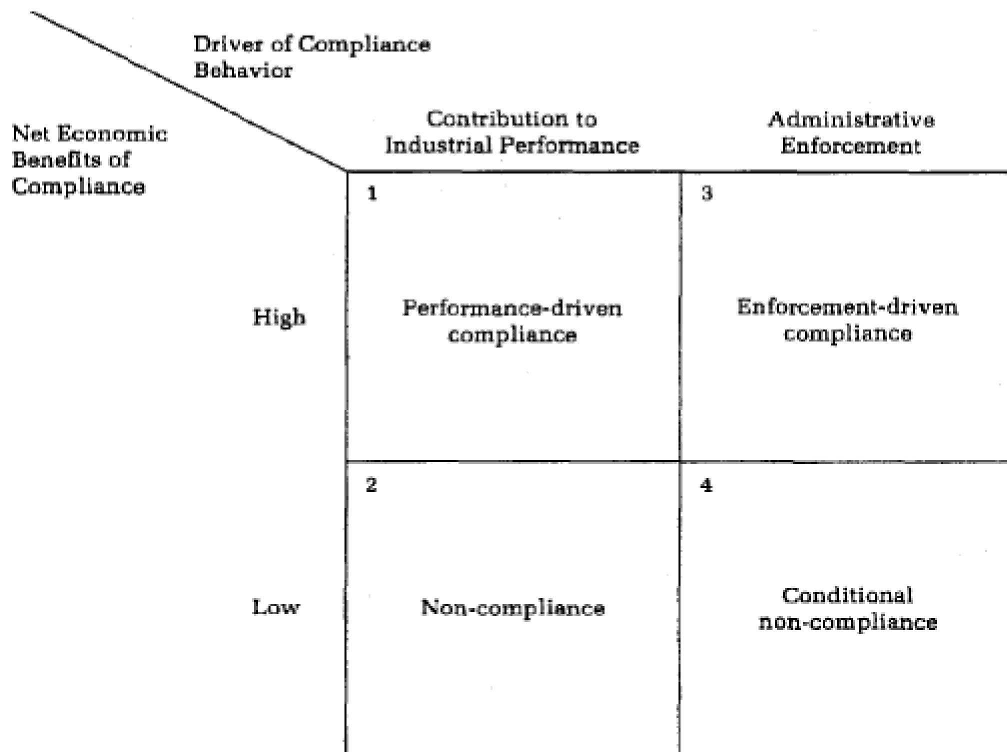

Figure 10: A managerial perspective on compliance with international environmental policies (Source: Rugman and Verbeke, 1998b)

In an international setting, the problem is whether the governments are willing and able to administratively enforce environmental regulation. This is often complicated, as the institutional environments of each country might differ and thus be affected in a different manner by the new imposed regulation. This can create “winners” and “losers” concerning the influence on economic conditions in the respective countries.

Rugman and Verbeke (2009) identify six elements that reflect the complexity of the interactions between international business and environmental regulations in comparison to the interactions at the national level:

- First and foremost, environmental policies are heterogeneous across countries, therefore MNEs have to either adopt country-specific environmental strategies, or set global standards, which would have to meet the most stringent regulations.

- If MNEs choose to implement global environmental standards to the entire MNE network, there is potential for scope economies in the environmental strategy area.
- Assuming a choice of global standards and the potential for scope economies, MNEs might advocate and voluntarily interact with governments in the development of international environmental standards.
- Following a pro-active environmental strategy, MNEs might develop green firm specific advantages that might contribute to competitive advantage.
- Considering the international dimension, there is a risk of a negative externality from one country affecting the reputation of the entire MNE network.
- Finally, environmental policy may be used to create entry barriers against rival corporations. This is closely related to first-mover advantages, and should be taken into account as a potential strategy to be used either by the firm itself or by competitors.

In his 1995 study on environmental practices and performance of US-based multinationals, Levy found that large MNEs are associated with better practices, but poorer environmental performance. Also, a relevant finding was that improvements in environmental performance were not associated with a better financial performance in the following years. On the contrary, as the author states, the reverse is more likely to be the case. It is important to note, however, that Levy's study is based on data from the UNCTAD 1993 report, which concluded that the most important factor responsible for changes in environmental management was legislation (Rugman and Verbeke, 2009). This leaves the possibility open, that improvements in financial performance might occur only in the case of harnessing first-mover or other firm-specific advantages as a result of a pro-active environmental strategy. Hence, we derive our next hypothesis:

Rondinelli and Berry (2000) argue that the key drivers of proactive environmental strategies are the potential for improvement in financial performance as well as environmental performance, while government regulation is clearly less important. An important insight from the same study tells us that environmental improvement

claims from external stakeholders are far less important than internal environmental practices geared towards improving both environmental and financial performance.

According to Kolk and Pinkse (2008), some firms would do better if they outsourced the “greening” process, as for them the development of firm-specific advantages might not be the most efficient use of their resources. This is especially the case in industries where environmental concerns are not highly salient. Thus, they should purchase best environmental practices (i.e. employee training programmes, environmental audits) from outside suppliers. However, Rugman and Verbeke (2009) argue that MNEs need to first take a strategic approach to environmental regulations, as they might obtain first mover and other firm-specific advantages.

3.2. Local versus global corporate sustainability strategy

According to various authors (Christmann, 2004; Husted and Allen, 2006; Pinkse et al., 2010), one of the most studied dilemmas of MNEs is whether sustainability practices can be adopted on a global level through a single standard, or whether adaptations to local subsidiary circumstances are necessary.

Aside from the decision of whether to develop green firm-specific advantages, managers of MNEs face the decision of whether to develop such capabilities locally or globally. There are arguments both for and against adopting global environmental standards. The global integration of corporate practices and strategies provides economics benefits in the form of economies of scale and scope and reputational benefits. However, the adoption of a global standard in corporate sustainability (which is usually the highest standard from the home country) requires unnecessary implementation costs in host countries that have less stringent legislative requirements, as the nature of environmental regulation that affects MNEs in host countries differs significantly across the globe, and requires at least some degree of local responsiveness to address the legislation and other institutional pressures. Furthermore, the different subsidiaries within the MNE network have diverging

capabilities and resources, and it is unlikely that they will be appropriately equipped to manage such external knowledge (Pinkse et al., 2010).

Buysse and Verbeke (2003), in a study on proactive environmental strategies, reached the conclusion that MNEs do not seem to tailor their environmental strategies based primarily on their home country regulations.

In contrast to the above findings, Dowell, Hart and Yeung (2000, p.1059) analyzed the market valuation of firms adopting global environmental standards versus firms reverting to low host country standards and found that “firms adopting a single, stringent global environmental standard have much higher market values, as measured by the Tobin’s q”. Although MNEs have been accused of avoiding a high global environmental standard in order to exploit the so called ‘pollution havens’, the above-mentioned authors found that 60% of the US-based MNEs observed in the sample use a single global standard, while less than 30% adhere to the developing countries’ standards.

Similar to the findings of Dowell, Hart and Yeung (2000) is the conclusion reached by Epstein and Roy (2007), which suggests that multinational companies recognize the long-term benefits of a global environmental standard such as a positive environmental image and a better environmental risk management. Moreover, MNCs probably anticipate increasing environmental regulations and want to anticipate global actions.

Seen through the lens of corporate strategy, the decision to adopt global or local environmental standards would lead to developing location-bound or non-location bound firm-specific advantages. Location-bound FSAs reflect advantages built by environmental management that are difficult to imitate by competitors. However, they can only be exploited locally or regionally and are hard to transfer internationally to other MNE subsidiaries. Non-location bound FSAs, in contrast, are transferable internationally and can be applied to any subsidiary (Rugman and Verbeke, 2009). It is important noting that the strength of national or international regulation is one of the main drivers of the decision to develop either location or non-location bound FSAs.

Escobar and Vredenburg (2011) argue that in the oil and gas industry, the institutionalization of sustainable development pressures is more likely to take place at the national than the international level, as the institutional pull from the host countries is stronger than the benefits of adopting a global standard. This conclusion, however, is specific for the oil and gas industry, which is characterized by weak and unclear regulation and enforcement mechanisms. The specifics of the industry (i.e. host countries are likely to be less developed countries, thus having weak regulatory requirements) also point toward a dispersed sustainability strategy.

However, if the firm decides to implement a global sustainability strategy, they can do so by allowing subsidiaries to build their own absorptive capacity, which would lower the cost of implementing a global environmental standard. Absorptive capacity is, according to Pinkse et al. (2010), the ability to value, assimilate and apply new knowledge. The authors argue that in comparison to other technologies, the need for local responsiveness will be higher when transferring environmental technologies, as public opinion plays a much more important role. The specific role that a subsidiary plays within the MNC is also an important factor in the implementation of globally standardized business practices, as subsidiaries vary widely in their ability to absorb and utilize capabilities. The findings suggest that, in general, it is beneficial for MNCs to build an environmental-specific absorptive capacity; however, it is overly costly to fully standardize all environmental practices due to high context specificity of environment-related knowledge. Consequently, there is a need to address the specifics of local subsidiaries by allowing for a certain degree of absorptive capacity to be developed by the subsidiaries. Moreover, subsidiaries have the capacity to develop specific capabilities, which cannot always be leveraged by the corporate headquarters. Therefore, by allowing subsidiaries to build a degree of absorptive capacity, they can “adapt global environmental practices more efficiently and thus lower the costs of a global environmental standard implementation” (Pinkse et al., 2010, p. 160).

Another MNC-specific task after deciding on a corporate environmental strategy is deciding on the supporting organizational structure. As shown in figure 11, Epstein

and Roy (2007) have found that companies that are diversified through different industries and operate in different geographical locations have adopted a decentralized organizational structure. Also, there is a positive relationship between the level of globalization of an MNC’s strategies and the level of globalization of its environmental policy. Thus, the organizational structure allows for a decentralized environmental strategy, but only in the case of environmental certification and objectives. The standards and evaluation systems remain centralized and set by the headquarters.

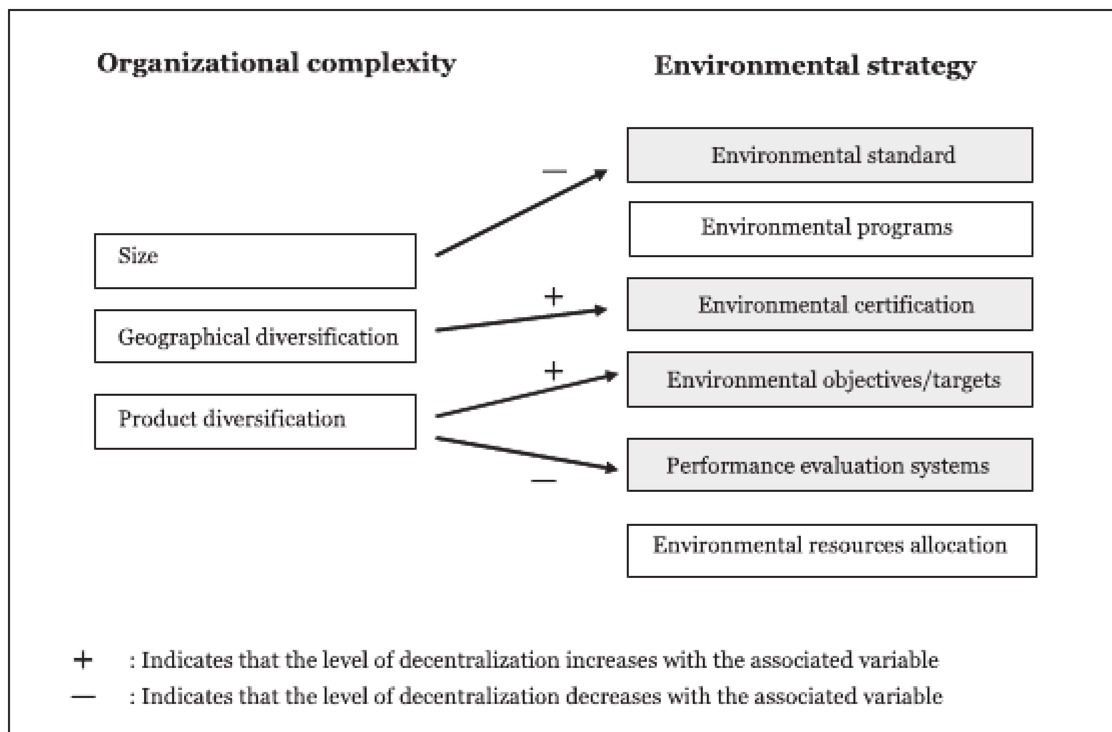

Figure 11: The relation between organization complexity and the level of decentralization of environmental strategy (source: Epstein and Roy, 2007)

According to Christmann (2004, cited in Epstein and Roy, 2007), MNCs are increasingly implementing more globally uniform environmental policies. However, pressures from different external stakeholders lead MNCs to standardize different aspects of their environmental policy. While global environmental standards are adopted primarily as a result of perceived government pressures, industry pressures are the factor that contributes to the standardization of operational environmental

policies. Additionally, customer pressures are responsible for the standardization of environmental communication.

Ruud (2001) discusses to what extent and how local environmental practices at affiliated units are influenced by transnational corporation headquarters in India. The findings suggest that environmental management at subsidiaries are strongly influenced by the headquarters' policies and standards, but with significant deviations from the intentions and policy commitments stated at the headquarters. Thus, institutional factors related to the intra-firm dynamics are important, but local factors still count in regard to the nature and content of environmental management at the subsidiary level.

4. Integrative framework

Drawing from the theoretical background discussed above, it becomes clear that managers will decide to adopt corporate sustainability only when it can be correlated with improvements in financial performance, which are seldom direct and clear. Very often the intermediate steps needed to be taken towards this goal are unclear and are accompanied by vague metrics, yet there are reasonable reasons to consider corporate sustainability as a source of competitive advantage.

The fact that some of the multinational companies have benefited from the adoption of corporate sustainability practices, while others refused to do so, and still maintained a high profitability and competitive advantage can lead to the conclusion that there are variables that determine whether corporate sustainability has an effect on firm performance. Under certain circumstances, the impact on corporate financial performance can be very high, while under other circumstances, the same measures towards achieving corporate sustainability might have only an incremental impact or no impact whatsoever. What are the factors and circumstances that dictate what the impact on corporate financial performance?

Based on the insights drawn from the stakeholder and institutional theories, as well as from the resource-based view, the following propositions are integrated to form a framework for identifying the circumstances, under which the adoption of corporate sustainability by MNCs has a positive effect on their financial performance.

The factors that determine whether the adoption of corporate sustainability practices will have any influence on corporate financial performance can be grouped in two categories: internal, which are firm-specific, and external, which are industry and location-specific.

Definitive stakeholder value on corporate sustainability

The first firm-specific circumstance is the value that a definitive stakeholder places on a corporation’s sustainability. Among the definitive stakeholder usually are

shareholders, which place an increasing importance on corporate responsibility, as they become aware of the financial liabilities that can arise from a poor environmental or social performance.

Stakeholder affinity to corporate sustainability is first a function of what groups belong to the definitive stakeholders - i.e. green consumers, non-governmental organizations that promote sustainability, the level of sustainability awareness of the community in which the corporation leads its operations. The more customers a business has that show an active interest in the way the products are sourced and disposed of, the higher is their affinity to corporate sustainability. If customers belong to the group of definitive stakeholders and the MNC decides on a strategy that takes into consideration and addresses their claims, their corporate sustainability practices are more likely to influence their financial performance. Hence, the relationship between stakeholder affinity to corporate sustainability and the effect on financial performance is expected to be positive. On the other hand, if definitive stakeholder groups are neutral to the sustainability practices of the corporation, the effect on financial performance is expected to be either insignificant or negative.

Firm size

Another factor that might influence the effect of corporate sustainability measures on financial performance is firm size. First, this relationship can be explained by the fact that large firms with substantial assets attract more attention from the media and legislators, which would lead to a higher propensity to address sustainability issues. Thus, large firms are more likely to implement various aspects of an environmental strategy in order to preserve their image and reputation. Second, large firms have more resources to invest in innovation in order to develop more efficient production processes. Even if the obstacles arising from complexity are more compelling in firms with more assets, their better access to resources allow them to leverage their investments in corporate sustainability and cultivate larger benefits. Third, unlike small and medium enterprises, managers of large firms are more likely to feel that their decisions have a real and significant impact on communities, economy and

environment and thus seek for ways to develop efficiencies in the production process and minimize their organization's impact on the environment at the same time.

Presence of complementary assets

According to the resource-based view, the competitive advantage of a firm lies in its resources and capabilities, which are different from competitors in the same industry. The firm is seen as a bundle of resources and capabilities that enable a firm to perform better or produce cheaper than its competitors.

Complementary capabilities are defined as existing resources that are required for the successful and beneficial implementation of a new strategy, technology or innovation. An example might be the "knowledge-based processes, such as quality-based and inventory control systems, which may assist with the development and implementation of environmental management systems" (Darnall and Edwards, 2006, p. 304).

Christmann (2000) identifies a relationship between product-focused and process-focused "best practices". The product-focused practices include redesigning the product packaging, developing new environmentally responsible products and advertising the environmental benefits of the products. The process-focused practices include redesigning and streamlining environmentally responsible production processes and development of pollution prevention and reduction technologies. However, firms will only be able to adopt product-focused strategies and differentiate if they have first made significant progress in the implementation of process-focused practices. Thus, process-focused strategies can be seen as a precondition to other environmentally and socially responsible practices that firms can adopt. As such, the process-focused practices can be seen as complementary capabilities to the adoption of product-focused practices.

In order to successfully implement process-focused strategies, firms have to possess resources and capabilities that are used in other productive processes. Thus, those resources and capabilities that are used in firms' other productive activities and that

are required for a successful implementation of a new innovation, strategy or technology, are the complementary assets.

Darnall and Edwards (2006) find that facilities with stronger internal capabilities and better access to resources prior to environmental management system adoption incurred lower adoption costs and relied to external resources to a lesser extent.

Consequently, it is safe to assume that given the presence of complementary resources and capabilities that MNEs have in regards to implementing corporate sustainability practices, firms are more likely to see a stronger effect of their sustainability strategy towards their financial performance.

Flexibility of resources and leveraging capacity

As discussed previously, another important insight from the resource-based view is the fact that flexibility of resources regarding their reversibility and leveraging capacity of resource commitments might improve financial performance. Following this train of thought, it is safe to assume that the effect on financial performance increases if the resources committed to corporate sustainability are flexible in regards to their reversibility and they possess firm-specific advantages that have a leveraging potential by committing resources to corporate sustainability.

International regulation

Corporate sustainability measures are expected to positively affect financial performance of MNEs in the absence of stringent international environmental regulation, but only when MNEs adopt pro-active environmental strategies. It is therefore imperative for companies to adopt corporate sustainability in settings that do not have very stringent regulation, but allow and support pro-active initiatives from MNEs. By anticipating strict regulatory requirements, organizations can invest in pollution prevention rather than pollution management technologies and thus decrease their costs by reducing reporting requirements. By becoming pro-active, MNEs can also accrue political capital with regulators and pro-environmental non-

profit organizations, which may prove beneficial in times of crisis (Darnall et al., 2008).

Market development stage

In industries with a high degree of product differentiation (i.e. food, pharmaceuticals, financial services, automobiles) firms are more likely to seek for new sources of competitive advantage and thus engage in activities that contribute to corporate sustainability. This is typical for industries in the growth or maturity life cycles (McWilliams and Siegel, 2001). Consequently, the effect of corporate sustainable activities on a firms financial performance is likely to be stronger in growing or mature industries. According to Chen et al. (2009), when MNEs operate in emerging markets that have entered the mature stage, the government expects MNCs to operate by socially responsible global standards, while the MNCs have the desire to adapt their environmental strategy to the expectations of local firms. Also, in industries that are in the growth stage, customers do not have a high purchasing power, and thus they do not value the corporate responsibility of the MNE.

The inverted U relationship

As depicted in figure 12, the mixed results of the research on the relationship between the adoption of sustainability measures and corporate performance might lead to the assumption of a non-linear relationship.

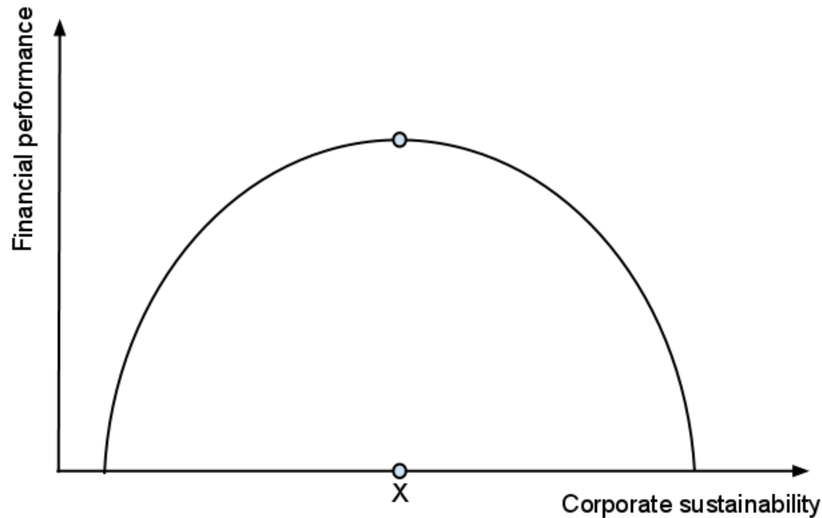

Figure 12: The inverted-U relationship between corporate sustainability and financial performance

According to this relationship, there is an optimal level of corporate sustainability practices that an organization should adopt, in order to financially benefit to full extent. Committing resources to a lesser extent will leave the company without exploiting the full extent of corporate sustainability, either through unfulfilled potential of efficiencies or economies of scale. Also, this would be the case where high switching costs are incurred for implementing a corporate sustainability strategy, without full exploitation of the benefits. Committing too many resources, however, may result in the company having very high costs, without it being necessary to address stakeholder and institutional pressures.

The framework

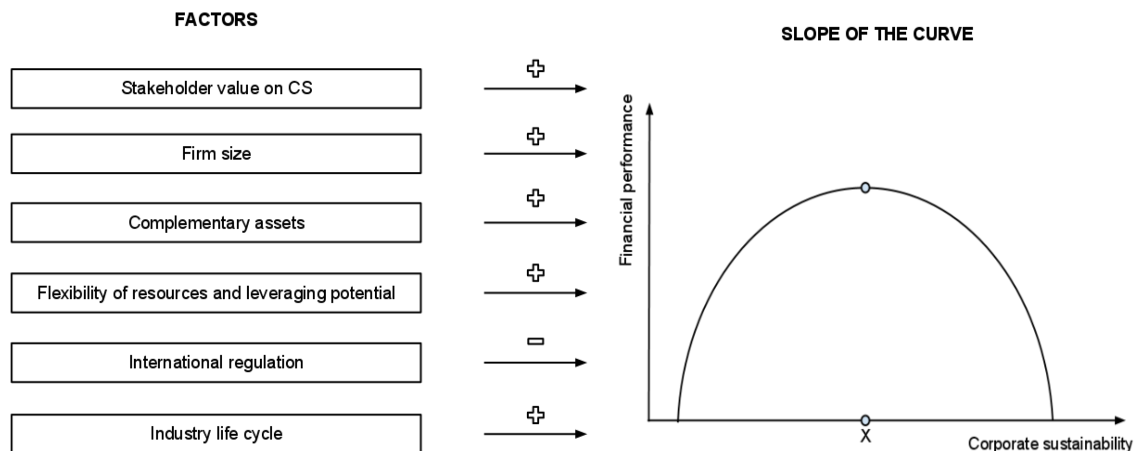

Figure 13: Integrative framework: factors influencing the effect of corporate sustainability on financial performance

Figure 13 depicts the effect that various factors or circumstances have on the relationship between corporate sustainability and financial performance. The slope of the curve is different for each firm, and a function of many factors, among which are the factors outlined above. It can be either flat or steep, depending on circumstances such as international regulation, firm size, flexibility of resources, etc. It is important to note that the relative importance of these factors has not been analyzed, nor are these all the circumstances to be taken into account when determining the slope of the curve and thus constructing a corporate sustainability strategy based on this data. The more valuable is corporate sustainability to definitive stakeholders, the stronger the effect of corporate sustainability on financial performance. This means that the curve will tend to be steeper for that particular firm.

The circumstances outlined above determine solely the slope of the curve. For each firm, considering their individual slope, managers should determine what the optimal level of corporate sustainability is (depicted in figure 13 with x), which would have the highest effect on firm performance. For some companies, the curve might be flat, meaning their financial performance will not benefit from the investments in corporate sustainability.

5. Conclusion and managerial implications

Although research concludes that managers need to prioritize and address stakeholder claims, be aware of the social, environmental and economic impacts that their managerial decisions have, there is little clear and definitive guidance to assist in their decision-making process. According to a McKinsey survey, most managers agree that they must be aware of the negative social and environmental effects that their corporate decisions are causing (Epstein and Widener, 2011). However, unless there are clear recommendations from the research community regarding an alternative direction and the benefits it might provide, managers are forced to find ways to “green-wash” their decisions rather than take a definitive approach to corporate sustainability.

McWilliams and Siegel (2001) argue that there is an optimal level of CSR, which managers can determine through a cost-benefit analysis. Because companies are at different development stages and in different circumstances, the optimal level of CSR supplied is different. So in order to maximize profit, the firm should adopt precisely that level of corporate sustainability, for which the increased revenue from addressing the definitive stakeholder needs and exploiting efficiencies from more sustainable production processes supersedes the cost of using resources to provide sustainable products.

The framework developed above is to be applied to one company at a time, and depending on the influence of the factors outlined above, managers can determine what the slope of the curve is and thus estimate the effect of their corporate sustainability strategy on the firm’s financial performance.

Managers of multinational corporations must also take into consideration the dynamic nature of the relationship between corporate sustainability and financial performance. The factors that lead to the decision of whether to adopt corporate sustainability strategies are related, and their influence on that relationship changes

in time. Thus, the framework should be applied periodically, with new circumstances and factors arising and others diminishing in relevance.

Both the proponents of sustainable development claiming that it marks a fundamental shift in development and critics arguing that it is still business as usual have a point in this discussion. The framework developed stays valid for both views. On the one hand, it shows that sustainable development pressures can lead to significant changes in the way business is conducted, however this depends on various factors, and is not the best strategy for all multinational companies. On the other hand, it is also true that business remains as usual in the sense that the bottom line is still profitability and financial performance, which is the sole determinant of whether sustainable development will be adopted through corporate sustainability.

An important implication for managers of multinational corporations drawn from the international regulations discussion is that managers should respond to legislative pressures with pro-active strategies. This framework will help managers decide if the conditions the MNE finds itself are beneficial for investments in corporate sustainability and to what extent to dedicate resources towards the goal of sustainable development. This is especially useful if the industry that the company operates in has not yet seen successful application of corporate sustainability strategies by their competitors.

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6. Appendix

6.1. Abstract (English)

Previous research on the link between sustainable development strategies and financial performance shows mixed results. The aim of this paper is to theoretically explain the reason for the mixed results and integrate the resource-based view, the institutional theory with the stakeholder perspective to form a theoretical framework that would allow for a better understanding for the link between sustainability practices and financial performance. The developed framework can be used by managers of multinational corporations to identify the circumstances and factors that would allow for a strong influence of corporate sustainability strategy on financial performance.

6.2. Abstract (Deutsch)

Unternehmensnachhaltigkeit spielt eine wichtige Rolle in internationale Unternehmensführung. Bisherige Forschungsarbeiten, die den Zusammenhang zwischen Strategien der nachhaltigen Entwicklung und finanziellen Erfolg untersuchten, zeigen uneinheitliche Ergebnisse. Das Ziel dieser Arbeit ist, die unterschiedliche Ergebnisse theoretisch zu begründen und die relevanten Theorien mithilfe eines Erklärungsrahmens zu integrieren. Der entwickelte Erklärungsrahmen kann den Führungskräften der multinationalen Unternehmen dabei helfen, die Faktoren zu erkennen, die den größten Einfluss der nachhaltigen Entwicklungsstrategien auf den finanziellen Erfolg ermöglichen.

6.3. Curriculum Vitae

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2005, August – Course of regional and cultural studies and German language at the Diplomatic Academy of Vienna
2006, March-today – Undergraduate study at the University of Vienna;
2008, July - Seminar „Leadership and motivation"

Work experience:

2008, February: Management assistant at Qidenus G.m.b.H.

Career objectives: Owning several online businesses
Management consultancy

Language skills: Romanian – Native
English – Fluent
German – Fluent
Russian – Good
Italian – Basic

Computer skills:	Windows:	Microsoft Office, Expression Web
	Linux:	OpenOffice
	Adobe Photoshop, HTML, CSS	
Interests:	Music, Team Sports, Dancing	