

The Business Case for Corporate Sustainability: Literature Review and Research Options

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In the last ten years, the notion of a ‘business case’ for corporate sustainability has increasingly been used by the corporate sector, environmental organizations, consultancies and so on, to seek justification for sustainability strategies within organizations. In this paper, we aim to systemize and assess existing research and tools related to this increasingly popular concept. We present a review of (1) theoretical frameworks, (2) instrumental studies aiming to either prove or disprove a hypothesized causal sequence between corporate social or environmental performance and financial performance, (3) descriptive studies examining manager’s actual perceptions and practices, and finally (4) tools. We identify a clearly insufficient understanding of manager’s key arguments or business logic for adopting corporate sustainability strategies (how ‘business cases’ are built, how effective they are and what barriers they face). We attribute this primarily to lack of descriptive research in these areas.

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Introduction

The business case is not a generic argument that corporate sustainability strategies are the right choice for all compa-

nies in all situations, but rather something that must be carefully honed to the specific circumstances of individual companies operating in unique positions within distinct industries. Successes in whole industries and at other companies are useful examples, but the case still has to be applied to one company at a time (Reed, 2001, p. 4).

The role of business in society has been a concern both of scholars and practitioners for a long time. As early as the 1960s, advocates of corporate social responsibility (CSR) put forward pragmatic arguments that pursuing such a route would limit regulation, as well as improving reputation and employee recruitment and retention (Davis, 1960; Whetten *et al.*, 2002; Wren, 1979).

According to Freeman’s stakeholder theory, corporations have responsibilities to their shareholders and other interest groups (Freeman, 1984). Although there is disagreement over the relative importance of these “stakes”, theorists agree that respect for issues other than economic ones is necessary. However, what is the financial payoff? The business case for sustainability (BCS) has been approached in many different ways to prove or disprove the sound economic rationale for corporate sustainability management that shall be defined as “a strategic and profit-driven corporate response to environmental and social issues caused through the organization’s primary and secondary activities” (Salzmann, forthcoming). Since the beginning of the 1990s, the BCS

received more and more attention from the corporate sector (Holliday, 2001; Holliday *et al.*, 2002; Schmidheiny, 1992; World Business Council for Sustainable Development, 2002), its stakeholders (WWF-UK, 2001), the academic community (Bonifant *et al.*, 1995; Dechant and Altman, 1994; Hart, 1995; Porter, 1987; Porter and Linde, 1995; Shrivastava, 1996; Zadek, 1999) and consultancies (Elkington, 1994; SustainAbility, 2001). Nevertheless, there is still substantial scepticism and uncertainty (Morsing, 2003; Walley and Whitehead, 1994).

In this paper the authors aim to comprehensively assess existing research and tools that deal with the BCS and point to the most significant research options.

Review of Research

Research on the BCS can be divided into two broad categories: theoretical studies and empirical studies. The theoretical studies are based on frameworks that aim to explain the nature of the relationship between financial performance (FP) on the one hand and environmental (EP) or social performance (SP) on the other. The empirical studies follow two lines of research: instrumental studies aim to empirically test the relationships hypothesized in theoretical studies; descriptive studies are intended to examine how companies and managers approach the BCS in practice.

Theoretical Studies

Over the past few decades several theoretical frameworks on the relationship between social or environmental and financial performance have emerged. In fact most of them refer to the relationship between social and financial performance, since they are largely based on the concepts of corporate social responsibility (Carroll, 1999) and corporate social performance (Wood, 1991). Although environmental issues, having a biophysical nature, are different from social ones, the theoretical frameworks that have been developed are valid for both dimensions of corporate performance. Hence, to be precise, the authors will refer to the relationship between finan-

cial performance (FP) and environmental/social performance (ESP) in the following. The frameworks differ in terms of the hypothesized causal sequence and the direction of the relationship (see Table 1).

The different frameworks are described in Tables 2–4 (Preston and O’Bannon, 1997).

Overall the current portfolio of competing theoretical frameworks is comprehensive. It is important to note that the typologies provided in Table 1 do not specifically allow for non-linear results such as an inverted U relationship. The inverted U suggests that there is an optimal level of ESP. Deviations from this corporate optimum are associated with lower levels of FP (Lankoski, 2000). Just such an inverted U relationship has been discovered by, among others, Bowman and Haire (1975), Sturdivant and Ginter (1977) and Lankoski (2000). This relationship is intuitively appealing, since “excessive” improvements in ESP (e.g. towards a zero emission goal) are extremely costly and would most certainly damage corporate profits (Salzmann, forthcoming). It also provides a partial explanation—alongside significant flaws in the methodology—for the failure of so many empirical studies to find one simple positive or negative association between FP and ESP. It is impossible to find a simple link because the companies surveyed were in all likelihood at different positions on the inverted U curve, depending on their individual cost/benefit situation.

Empirical Studies

Instrumental Studies

Instrumental studies try to empirically confirm or deny a hypothesized causal sequence and/or link between FP and ESP retrospectively. They follow two broad streams of methodology, namely largely qualitative case studies and quantitative analyses.

Case studies are dominated by stories about successful pollution prevention projects and cost savings in mature, commodity and extremely price-sensitive sectors such as chemicals. They also refer to other issues, such as risk avoidance and corporate sustainability as part of business excellence (Weiser and Zadek, 2000). Case studies have two essential draw-

Table 1 Typologies for ESP-FP Relationship—Based on Preston and O’Bannon (1997, p. 422)

Causal sequence	Direction of the relationship		
	Positive link	Neutral link	Negative link
ESP leads to FP	Social impact hypothesis	Supply and demand theory	Trade-off hypothesis
FP leads to ESP	Available funds hypothesis or slack resources theory	of the firm	Managerial opportunism hypothesis
ESP and FP are synergistic	Positive Synergy		Negative synergy

Table 2 Frameworks Suggesting a Negative Link between FP and ESP

Framework	Description	Empirical evidence
Trade-off hypothesis (Friedman, 1962): <i>Higher ESP leads to lower FP</i>	Reflects Friedman’s neoclassical argument that firms have only one social responsibility, which is to increase profits. By increasing ESP, they unnecessarily incur costs and reduce their profitability.	Vance (1975)
Managerial opportunism hypothesis (Preston and O’Bannon, 1997): <i>Higher FP leads to lower ESP</i>	Managers will reduce expenditure on ESP when FP is strong to maximize personal compensation (which is tied to short-term FP).	Posner and Schmidt (1992) and Alkhafaji (1989)
Negative synergy (Preston and O’Bannon, 1997)	Simultaneous relationship combining trade-off and managerial opportunism hypothesis.	

Table 3 Frameworks Suggesting a Neutral Link between FP and ESP

Framework	Description	Empirical evidence
Supply and demand theory of the firm (McWilliams and Siegel, 2001): No link between SP and FP	Companies supply a demanded and unique level of ESP to maximize their profits.	Some studies found no or inconclusive correlations (Anderson and Frankle, 1980; Aupperle <i>et al.</i> , 1985; Freedman and Jaggi, 1982)

Table 4 Frameworks Suggesting a Positive Link between FP and ESP

Framework	Description	Empirical evidence
Social impact hypothesis (Cornell and Shapiro, 1987) <i>Higher ESP leads to higher FP</i>	Meeting the needs of various non-owner stakeholders increases FP. Failure to meet less explicit needs of stakeholders generates market fears (i.e. affects company reputation), thus increasing a company’s risk premium and affecting FP. Actual ESP costs are minimal compared to the potential benefits.	Pava and Krausz (1996) and Preston and O’Bannon (1997)
Available funds hypothesis or slack resources theory (Waddock and Graves, 1997b) <i>Higher FP leads to higher ESP</i>	Superior FP enables companies to devote more resources to ESP.	McGuire <i>et al.</i> (1988), Kraft and Hage (1990), partially Moore (2001)
Positive synergy: “Virtuous circle” (Waddock and Graves, 1997a)	Simultaneous relationship combining slack resources and good management Good management does most things well, including both ESP and FP. Good management and good ESP are synonymous when ESP is defined in terms of the stakeholder relationships considered important to the firm’s performance and not in terms of discretionary activities, e.g. philanthropy.	Empirically supported by Preston and O’Bannon (1997), Pava and Krausz (1996) and Stanwick and Stanwick (1998)

backs. First, the evidence presented is often not hard enough, since it is based on qualitative data; and, second, (they are often only valid for a specific sector or company, hence their applicability is limited.

Quantitative analyses are based on three different methodologies:

- (1) Portfolio analyses compare the performance of constructed model portfolios with a benchmark index. However, the results are ambiguous and contingent upon different factors such as the time period under consideration, risk adjustments and the re-weighting of portfolios.

- (2) Event studies assess the impact of good or bad environmental or social incidents on companies' share prices. Although the results show share price movements, studies are short term—sometimes limited to only a few days.
- (3) Multivariate analyses examine associations between different measures of FP and ESP. Some studies also control for the influence of potential moderating factors such as company size and risk.

Probably the most significant study in this area has been carried out by Lankoski (2000), who empirically analysed the influence of industries, plants and time on environmental profit, i.e. the scale of the business case for reducing effluent discharges.¹ It is most important to note that Lankoski found that plants had roughly forty times more effect on environmental profit than crude industry effects (e.g. chemical, forestry, metal). This clearly points to a lack of differentiation in instrumental studies so far. All in all, results are largely inconclusive (Arlow and Gannon, 1982; Cochran and Wood, 1984; Frooman, 1997; Griffin and Mahon, 1997 in particular). The "overwhelming preponderance" of evidence indicating that good ESP is associated with good FP (Pava and Krausz, 1996) does not convince sceptics, since results are subject to research bias, exhibit great variation and are ambiguous regarding the causal relationship between the two concepts. The wide majority of studies appears to be focused on multi-industry US samples, leaving a vast research area of single industry sectors and geographical areas such as Europe as well as comparative approaches largely untouched.

In addition to the complexity of the research area, which results from the variety of environmental and social issues that affect different industries in different countries, the inconclusiveness of the results can be attributed to the following shortcomings in the methodologies:

1. The use of a wide variety of sometimes poor ESP measures. Since its introduction in 1982, the Fortune Corporate Reputation Index has been increasingly used as a data source leading to more consistency with respect to ESP measures. Several authors have argued for the use of multidimensional ESP measures (Freedman and Jaggi, 1982; Griffin and Mahon, 1997; Ullmann, 1985; Wood and Jones, 1995), which could facilitate a more comprehensive (perceptual and factual) and thus accurate measurement of ESP. However, multidimensional measurement naturally leads to limited sample sizes.
2. Lack of effort to empirically test definitions and concepts.
3. Lack of significance testing and control for interaction with other variables—particularly in the early studies.
4. Inadequate sampling techniques, also due to limited data availability. Empirical studies have focused mainly on large, pan-sector samples, which may have masked sector-specific differences such as unique internal competencies, external pressures, degree of public visibility, stakeholder configurations, level of regulation, etc. A few studies took more differentiated perspectives (Greening, 1995; Moore, 2001; Simpson and Kohers, 2002) by focusing, for example, on one particular industry or comparing different industries and plants.
5. The use of a variety of FP measures, presumably for reasons of convenience. The argument about the appropriate FP measure appears to be ongoing. Both accounting and market-derived measures focus on different aspects of performance and are subject to particular biases. Whereas accounting measures can be confounded by different accounting procedures and asset allocations across different industry sectors, market-derived measures may reflect more than just financial performance.

Results of instrumental studies suggest that the FP-ESP relationship is complex and contingent on situational, company- and plant-specific factors that are difficult to detect through most analytical approaches. Furthermore, the issue of the causal sequence between FP and ESP remains unresolved.

Descriptive Research

Managers' Attitudes. Various authors (Bowman, 1977; Cruz Deniz-Deniz and Garcia-Falcon, 2002; Holmes, 1976; Marz *et al.*, 2003; Quazi and O'Brien, 2000; Rojsek, 2001) have analysed managers' social orientation or the perceptions of corporate social responsibility and related concepts. Unexpectedly proactive attitudes of respondents are obviously due to social desirability bias.²

Since these studies primarily examined managers' attitudes towards the responsibility of business (Which issues should be taken into consideration, which stakeholder demand should be met?), they are by design not very effective at providing significant insights into the nature of the BCS. They rather point to the need for a sound BCS, since managers are naturally focused on the economic dimensions of corporate responsibility.

Companies. A great number of studies have examined internal and external drivers and barriers to corporate sustainability management (Bansal and Roth, 2000; Henriques and Sadosky, 1995; Lawrence and Morell, 1995; Sharma *et al.*, 1999; Skjaereth and Skodvin, 2001; Winn, 1995). Some of them implicitly took the economic rationale into consideration. How-

ever, the literature reveals two significant shortcomings:

- ❖ There is a clear lack of comparative approaches. Few studies have taken an explicit cross-industry approach such as Henriques and Sadosky (1996) and Banerjee *et al.* (2003) have done. None have accounted for both industry and country effects.
- ❖ Even fewer studies have explicitly concentrated on the BCS as a driver of corporate sustainability management, i.e. what determines the BCS, how strong is the need for it? Again Lankoski's study constitutes a rare exception because it reports on several major determinants of environmental profit, including technology, regime (regulatory and economic "rules" of the game) and visibility (Lankoski, 2000).

It is also striking how little empirical research has dealt with the BCS on a more organizational level so far, i.e. how it is built and used in companies. Epstein and Roy (2001, p. 589) presented a framework that should assist managers in operationalizing corporate sustainability strategies based on economic rationale. They also analysed 20 external corporate reports in terms of how companies used systems and measures to link environmental and social activities to long-term financial performance (Epstein and Roy, 2003). Ruud (1995) assessed the rationality of corporate environmental actions of

transnational corporations involved in bauxite mining.

Review of Tools

Several scholars, think-tanks and consultancies have also worked on the BCS. Their efforts can be broadly assigned to three categories: (1) Collections of evidence on the BCS and broad recommendations for actions; (2) "Coaching" tools that serve as a detailed roadmap for managers on how to build their BCS; and (3) Valuation tools that are designed to quantify the BCS. In the following Tables 5–7, the authors briefly describe some examples for each of the three categories.

All three kinds of approach are worthwhile. They are complementary means of increasing managers' understanding of the BCS. However, the following issues and stumbling blocks remain:

1. Collections of evidence and recommendations for action commonly rely on more general and partly anecdotal data. They are not very effective at facilitating managers' decision-making in a specific situation because of the complexity of the BCS, which varies across several dimensions such as industries and plants.

Table 5 Collections of Evidence and Broad Recommendations for Actions

Tool/Project	Description
EarthEnterprise tool kit (International Institute for Sustainable Development (IISD), 1994)	<ul style="list-style-type: none"> ❖ Helps companies to "build new kinds of business" ❖ Primarily targets the North American entrepreneur in a small or medium-sized green or sustainable enterprise ❖ Provides "strategic advice and specific, action-oriented suggestions to deal with real business problems" in the areas of consumer markets, green procurement, technology etc. ❖ Includes a list of information sources for follow-up
Conversations with disbelievers (Weiser and Zadek, 2000)	<ul style="list-style-type: none"> ❖ Review of almost exclusively quantitative evidence showing when corporate engagement (exclusively referring to the social dimension of sustainability) creates business and societal benefits ❖ Target group: "people who seek to persuade sceptical managers and executives" ❖ Features: Assessment tool for evidence collected, and a "data warehouse", based mainly on US and UK examples
Buried treasure: Uncovering the business case for sustainability (SustainAbility, 2001)	<ul style="list-style-type: none"> ❖ Systemizes the BCS in "The Sustainable Business Value Matrix" along two dimensions: business success (financial performance, financial drivers) and corporate SD (sustainable development) performance ❖ Links business success and corporate SD performance through logical arguments and corresponding empirical evidence

Table 6 Coaching Tools

Tool/Project	Description
To whose profit? Building a business case for sustainability (WWF-UK, 2001)	<ul style="list-style-type: none"> ❖ Designed to “guide senior managers as they work towards building their own business case” ❖ Reviews existing evidence supporting the BCS ❖ Provides a route map towards the BCS, which consists of six steps ranging from (1) identifying impacts to (6) determining preferred actions for inclusion in a business case ❖ Methodologies for every step are mentioned and briefly explained
Die Compass-Methodik. Companies and sectors path to sustainability (Kundt and Liedtke, 1999)	<ul style="list-style-type: none"> ❖ Originally developed for product lines and regions ❖ Comprises 5 modules including COMPASS profile, vision, analysis, management and report ❖ The management module assists with building the business case internally and with operational roll-out (e.g. cost and resource management, stakeholder dialogue, conflict management)

Table 7 Valuation Tools

Tool/Project	Description
Pure profit: The financial implications of environmental performance (Repetto and Austin, 2000)	<ul style="list-style-type: none"> ❖ Scenario-based methodology uses standard techniques of financial analysis to derive measures of expected environmental impacts on share values and financial measures of environmental risk ❖ Applied to 13 major US pulp and paper industry companies ❖ Findings: Even though the underlying scenarios and probability assumptions are the same for all companies, risk exposure and financial implications differed significantly from company to company in terms of the most likely outcome (mean), the range of possible outcomes (variance) and their degree of imbalance towards negative and positive outcomes (skewness)
Stalking the elusive business case for corporate sustainability (Reed, 2001)	<ul style="list-style-type: none"> ❖ Elaborates on the fundamentals of the BCS ❖ Describes several conventional valuation methodologies and emerging methods to quantify the BCS financially

2. Coaching tools attempt to fill this void by providing managers with guidelines, checklists and other methodologies. Some of those tools such as WWF’s route map towards the business case are very comprehensive. However, two essential questions remain: How much are coaching tools applied in practice? The most obvious barriers to their application are the tools themselves (too general, too specific, too technical, etc.) and their users, i.e. the managers (time pressure, reactive mindsets and lack of knowledge). Besides, one should not rule out an even more essential barrier in advance: The tools may not be needed as much as scholars and consultants expect. This leads us to the second open question: Do coaching tools (or tools in general) represent the most effective approach to promoting corporate sustainability management? In this respect more empirical research into the internal barriers and the exact needs of managers for the BCS is clearly needed.

3. Valuation methodologies are less known and hardly used in the business community. This is presumably because they are new and demand-

ing, and may thus overwhelm managers who lack the necessary financial expertise. And, because of the complexity of environmental and social issues, there may be insufficient mechanisms to gather and organize the data required (Reed, 2001, p. 3).

Conclusion

The previous sections have revealed a distinct focus in existing literature on theoretical frameworks and instrumental studies. The latter do not provide much convincing evidence because:

- (1) Qualitative studies (case studies in particular) are not representative and thus are often only applicable to a single company or sector, and
- (2) Quantitative studies yield inconclusive results. Methodologies have improved significantly over the last three decades (Lankoski, 2000). However, there is still a clear lack of (i) sector-specific

research to facilitate more accurate measurement and thus increase internal validity, and (ii) comparative (cross-industry, cross-country or cross-functional) studies.

It should be noted the BCS as a research topic is inherently linked to two major stumbling blocks, which may also prevent more conclusive results of quantitative instrumental studies in the future:

- ❖ *Complexity*: The nature of the BCS is extremely complex since it is contingent on a number of parameters (e.g. technology, regime and visibility) that vary between industries, plants, countries and different points in time.
- ❖ *Materiality*: The BCS may exist but may often be marginal in practice and/or difficult to detect. It appears to be mostly limited to the reduction of downside operational risk and to measures to increase eco-efficiency, the “no-brainers” of good (rather than corporate sustainability) management. The economic value of more sustainable business strategies is a lot more elusive, since it only materializes in the long term. Furthermore, effects on intangible assets (e.g. brand value, employee loyalty) are difficult to quantify.

Descriptive studies have largely concentrated on managers’ attitudes towards corporate sustainability management and related concepts. They provide little insight into the characteristics of the BCS because their main interest is managers’ viewpoints on what their companies should do to be responsible. Obviously managers’ clear focus on economic responsibilities points to the need for a sound BCS.

The lack of descriptive studies on the importance and role of the BCS in companies was identified as the greatest gap in the existing literature. Most importantly, research so far has failed to:

- (1) Identify managers’ key economic arguments used to drive corporate sustainability management internally.
- (2) Examine how managers build these arguments (e.g. more qualitatively or quantitatively, using what tools and processes exactly?).
- (3) Assess the effectiveness of individual arguments and the corresponding success factors and barriers.

Hence the authors call primarily for descriptive research in this area that should either focus on specific target groups, i.e. sectors, countries and management functions, to increase the internal validity of results or adopt a comparative approach across sectors, plants, etc. to identify common patterns or variations. Such studies will result in a more thorough understanding of managers’ perceptions of the BCS and will thus also shed more light on the use and effectiveness of the tools presented in the section

above. In this way, they will make a greater contribution to both the practice and scientific understanding of the BCS than other research options.

Notes

1. Environmental profit was operationalized as overcompliance, i.e. a perceived win-win situation, measured as the percentage share of actual effluent discharges in the permitted effluent discharges.
2. According to Bowman, a majority of executives believe that environmental problems should be taken into consideration even if it means a reduction in profits, slowing down the introduction of products, etc. (Bowman, 1977). In contrast, Heald concludes that executives are significantly preoccupied with philanthropic activities and community relations (Heald, 1979).

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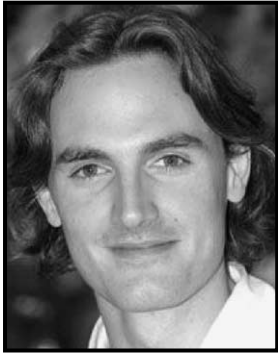
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