

# Corporate Environmental Responsibility

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# Corporate Environmental Responsibility

*Edited by*

Neil Gunningham

*Australian National University, Australia*

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# Series Preface

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The conduct and governance of corporations raise a host of economic, political and social issues of central importance to human wellbeing in the 21st century. The economic capacity and consequent power of corporations make them institutions with the potential for enormous benefit and grievous harm. It is, therefore, crucial to identify the various advantages and disadvantages of the corporate form and how it is utilised, and to work out how to maximise the economic gains while minimising the social and environmental losses deriving from corporate activities. This requires an appreciation of how the corporation contributes to prosperity and human wellbeing, and what risks it poses to the natural and social environments in which it operates.

Since the benefits of corporations are dependent on the exercise of corporate freedoms, and countering the potential harms sometimes requires restrictions on those freedoms, there are structural tensions in developing ethical and legal norms for corporate governance. Moreover, corporate freedoms work well for enhancing prosperity only within an appropriate competitive setting which is itself dependent on mutual trust and a regulatory framework, particularly if it is considered a benefit to achieve an equitable distribution of that prosperity. It is, therefore, a complex matter to gain an overall picture of the corporate rights and responsibilities that are appropriate within a good society, both domestic and global.

This series of five volumes on corporate responsibilities gathers together crucially important essays on different dimensions of corporate responsibility. The essays are selected and introduced by internationally recognised specialists in the field. Each volume provides a different perspective and concentrates on distinctive issues.

Corporate Business Responsibility (Vol I), edited by Justin O'Brien, Research Professor of Law and Corporate Governance at Queensland University of Technology, focuses on the responsibility of the corporation to enhance and sustain share value within the norms of fair competition. Business responsibility constitutes the distinctive core duty of the corporation as the creature of its investors to maximise its profitability in the interests of its legal 'owners' to whom managers and boards are ultimately accountable. This core business duty operates within a wider context of legal and social norms that are directly integral to the conduct of business in a competitive market system which aims at the economic success not only of particular businesses but of business in general.

Corporate Environmental Responsibility, (Vol. II), edited by Neil Gunningham, Professor of Environmental Law at The Australian National University, centres on the responsibility of corporations towards the natural environment, taking into account the economic, social and intrinsic reasons for preserving and enhancing the natural environment. It deals with the ethical basis for requiring corporate management to factor-in environmental considerations to their economic decision-making, including and going beyond the purely business case for environmental risk management. Essays dealing with 'smart' regulation and internal management policies to protect the environment both nationally and internationally are included.

Corporate Social Responsibility (Vol. III), edited by Wesley Cragg, Professor of Business Ethics, Schulich School of Business at York University, Mark Schwartz, Professor of Business Ethics, Faculty of Professional and Liberal Studies, York University, and David Weitzner, Professor of Strategy and Ethics, Schulich School of Business, York University, examines the emergence of the concept of corporate social responsibility and the use and uses that have been made of the language of corporate responsibility to explore the business/society relationship, or what might be described as the role of the modern corporation in contemporary society. Central to this volume is the challenge of identifying and balancing a corporation's financial and non financial obligations to a wide range of stakeholders including shareholders but also employees, consumers, suppliers and communities affected by its operations. Issues discussed include the ethical bases for these social responsibilities, their practical application, their ongoing implications for business management and the efficacy of voluntary self-regulation.

Corporate Governance (Vol. IV), edited by Lawrence Mitchell, Theodore Rinehart Professor of Business Law, The George Washington University, Washington DC, deals with corporate governance from the point of view of managing and being accountable for the full range of corporate responsibilities. It explores different visions of the corporation in terms of ownership and as a social entity. The structure of the corporation, its legal bases and economic functions are examined. Particular attention is given to the role of the Board of Directors and shareholders in holding management accountable and taking responsibility for corporate conduct.

Sustainability (Vol. V), edited by Tom Campbell, Professorial Fellow in the Centre for Applied Philosophy and Public Ethics (CAPPE) at Charles Sturt University, and David Mollica of The Australian National University, focuses on the concept of sustainability and its relevance to the articulation, development and enforcement of corporate responsibilities. Essays are included which trace the origins and multiple meanings of 'sustainability' within a range of disciplines, including ecology, economics and politics, and the ways in which they reflect shifts in value priorities, corporate policies, compliance mechanisms, and issues of global and domestic social justice. Consideration is given to the benefits and drawbacks of utilising the concept of Sustainability in theorising and presenting the legal and ethical responsibilities of the modern corporation.

Together these five volumes provide a wide-ranging picture of contemporary thinking on corporate responsibilities, taking in debates about their proper content and the legitimate and effectual means of their enforcement.

TOM CAMPBELL

*Series Editor*

*Professorial Fellow, The Centre for Applied Philosophy and Public Ethics (CAPPE),  
Charles Sturt University, Canberra*

# Introduction

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Over the last two decades a remarkable transformation has taken place in the relationship between business and the environment. Traditionally, industry has been accused of ‘environmental rape and pillage’ and of sacrificing sustainable development to the pursuit of short-term profit. Yet today, under the banner of corporate environmental responsibility (CER), a growing number of business organizations are claiming to be part of the solution rather than part of the problem. Such organizations are seeking to improve their environmental performance and to mitigate their environmental harm and, for the most part, to do so in ways that provide them with a competitive advantage. Initiatives as diverse as pollution prevention, material and energy efficiency initiatives, the development of clean technology and product stewardship are all taking place under the auspices of CER and are variously intended to realize new market opportunities, generate cost savings and improve efficiency, reduce environmental risk and enhance corporate image.

So what is this emerging phenomenon of CER? What does it aspire to achieve? How pervasive is it and what are its implications for both business and the environment? Here, definitions are crucial, not least because there is so little agreement about what CER involves. Accordingly, no account can sensibly proceed without making clear what, for the writer’s purposes, is included within its ambit and why.

CER is really a subcategory of the broader concept of corporate social responsibility (CSR). In definitional terms, this is of little help, since there is equally no consensus as to what the latter involves. Necessarily, it refers to voluntary and unenforceable action beyond that which is required by law (since there is little responsibility or virtue in simply complying with legal obligations). But whether this must be a product of ethical considerations or whether conduct motivated by public pressures, social expectations or economic self-interest should also be included remains a moot point (Baron, 2003, pp. 8–11). Similarly, CER is widely accepted to imply action ‘beyond compliance’, usually with the expectation that it will contribute to ‘sustainable development’. However, this takes us little further since the latter is itself an ambiguous, and perhaps vacuous, term. For some it encapsulates the shift in thinking from environment versus development to environment *and* development, but for others it is no more than a ‘buzzword devoid of content’ (Esty, 2001, pp. 74–5). As with CSR, the central definitional question becomes whether self-interested action (such as strategic environmental initiatives to cut costs, protect a corporate brand or mitigate social pressure) would constitute CER or whether only action which is engaged in for altruistic reasons should fall within the definition.

Unsurprisingly, since definitions have persuasive significance, in shaping perceptions and influencing outcomes, different stakeholders prefer different definitions. Business leaders and their representative organizations are clear that CER embraces ‘beyond compliance’ behaviour engaged in for strategic reasons, irrespective of whether it has any altruistic underpinning. Indeed, these groups imply that unless there is ‘business case’ for CER, it would be unrealistic to expect it to occur.

In contrast, environmental non-governmental organizations (ENGOS), seeking to persuade their audiences that corporations should do far more to protect the environment than whatever their business case dictates, argue for a much more expansive definition. For example, Pollution Probe, seeking to distil the perspectives of Canadian ENGOS, identifies as critical ingredients of CER: environmental commitment and awareness; stakeholder engagement; measuring, reporting and auditing; transparency; and commitment to continuous improvement – as well as going beyond compliance (Pollution Probe, 2008). For them, CER incorporates three broad themes:

1. environmental commitment in which the company fully embraces sustainability and has a net positive impact on the environment and society;
2. material and energy management in which the company operates within the finite ecological limits of the environment; and
3. effective stakeholder engagement in which the company is fully transparent and accountable, with a demonstrated process in place to engage and empower stakeholders.

As will be apparent, this approach incorporates the narrower definition preferred by business organizations but also goes substantially beyond it.

But, whatever the merits of the Pollution Probe approach, it has few supporters outside the ENGO community, and it and other broad ENGO definitions are strenuously opposed by business. For our present purposes, a ‘lowest common denominator’ definition is preferred, not because of any normative preference for the business community’s view but rather because it enables a wide-ranging exploration of the CER literature, including what has become the central issue within it – the relationship between CER and competitive advantage. Specifically, CER will be defined as: *practices that benefit the environment (or mitigate the adverse impact of business on the environment) that go beyond that which companies are legally obliged to do*. This definition is broadly consistent with that put forward by the World Business Council for Sustainable Development (WBCSD),<sup>1</sup> although the WBCSD view also refers to the business case for such action. In contrast, had the aspirational ENGO definition been adopted, there would have been very little additional business behaviour to write about. This in itself may tell us something important about the limitations of CER in its present form – an issue that will be revisited later in this Introduction.

In terms of the definition stated above, there is a fast-growing literature focusing specifically on what companies can and should do with regard to CER, on the strengths and limitations of CER, and on whether or to what extent it can contribute both to mitigating environmental degradation and to a more sustainable future. It is this literature and these themes that will be explored in this volume.

This Introduction aims to map the development of the CER concept, trace the principal debates concerning its contribution to environmental protection, examine the arguments about the relationship between CER and competitive advantage, assess the evidence as to what

---

<sup>1</sup> See generally the WBCSD website: <http://www.wbcd.org>. See also the Commission of the European Communities’ definition: ‘A concept whereby companies integrate ... environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis’ (Pattberg and Stripple, 2007, p. 126).

extent corporations are seeking to ‘do well by doing good’ and explain why some companies have gone down this path when others, similarly situated, have been unwilling to do so. In essence it asks: ‘What has CER accomplished, what can it accomplish and what is beyond its reach?’ This examination will enable the essays collected in this volume to be more readily located within the context and wider framework of the contemporary CER debate.

### **The Development of CER: The First-generation Debates**

The broader debate about CSR began in earnest when Milton Friedman (1970) famously declared that the sole business of the managers of a publicly-held corporation was to maximize the value of its outstanding shares. Friedman’s view that using corporate resources for altruistic purposes was anathema (and indeed should be prevented by corporate law) is widely held and is particularly dear to neoclassical economists. The latter are also inclined to ask why (assuming them to be profit-maximizing ‘amoral calculators’) business firms would *want* to do more than the law requires, since environmental protection measures are often expensive and usually do not, in any obvious way, provide the company with any marketplace advantage. On both grounds, the conventional wisdom was that spending beyond that required by law, on matters such as environmental protection, was entirely without justification.

But by the 1990s the second assertion – that corporate spending on environmental protection will almost inevitably impose costs rather than benefits – was widely challenged. A variety of business strategists and environmental commentators, and, ultimately, some corporations themselves, argued that the business community could successfully combine the objectives of environmental protection and economic growth. This might be achieved, for example, by preventing pollution and thereby cutting costs and avoiding waste directly, by more effective risk management (including minimizing the risk of accidents, costly clean-ups, and environmental liability) or by gaining an increasing share of expanding ‘green markets’ or price premiums within them. In engaging in initiatives to achieve such ends, smart corporations could not only ease the pressures imposed by regulators and the public, but also increase profits directly and develop the environmental technologies necessary to compete effectively in the global environmental market.

*If* this was correct, then even Friedman and his followers would concede that it was in the economic interests of business to go down this path – that is, there would be no conflict with the first assertion above. Although Friedman’s followers were unlikely to use the language of CER or align themselves with the aspirations of its proponents there was, in practice, far less for the two groups to disagree about than it might appear.

Much of the debate during the 1990s took place within the pages of the *Harvard Business Review*, with many of the most influential essays addressing the issue of whether environmental spending was ‘win–win’ (in which case environmental protection and economic growth could be combined) or ‘win–lose’ (in which case they could not). Strong advocates of the former view were Amory Lovins, Hunter Lovins and Paul Hawken (Chapter 1) who argued the importance of taking advantage of ‘natural capital’ – the natural resources and ecosystem services that make possible all economic activity – and valuing it appropriately. In their view, if due recognition is given to natural capital, then business and environmental interests substantially overlap, and businesses will be able to satisfy their customers’ needs, increase

profits and help solve environmental problems all at the same time. The preface of their book, *Natural Capitalism* states that:

It is a portrayal of opportunities that if captured will lead to no less than a transformation of commerce and of all societal institutions. Natural capitalism maps the general direction of a journey that requires overturning long-held assumptions, even questioning what we value and how we are to live. (Hawken, Lovins and Lovins, 1999, p. xi)

Many of the resulting savings resulting from natural capitalism would be relatively easy to obtain. For example the authors give the example of a company, one of whose processes used 14 pumps. An energy efficiency review generated energy savings of 92 per cent, reduced the system's capital cost and made it more compact, easier to build and maintain and more reliable. All these results required only two changes in design: choosing big pipes and small pumps instead of small pipes and big pumps (thereby reducing friction) and laying the pipes first and then installing the equipment rather than the reverse (enabling the laying of straight pipes with more insulation and greater efficiency) (Ibid.).

Stuart Hart (1997), albeit from a different angle, also pointed to considerable environmental opportunities for business. These will arise, he argues, not just through reducing pollution and increasing profits at the same time, or by risk reduction, re-engineering or cost-cutting (which leading companies had been doing for some time), but by going 'beyond greening'. By this he meant moving beyond pollution prevention to product stewardship and the development of clean technology, which would, if approached strategically, make sound business sense. Currently, he argued, there is a large gap between the fully rational, full information of neoclassical economic theory and the reality of business practice, and, as a consequence, firms miss many opportunities to reduce costs. 'Beyond greening' strategies however, would facilitate both business advantage and sustainable development. Hart's position, as explained in his essay in this volume (Chapter 2) is representative of the 'natural resource-based view of the firm', which views the technological, organizational and human resources that can be turned to environmental ends as increasingly valuable and draws the link between environmental capacities and strategic competitive advantage. Some empirical support for this position was subsequently provided by Russo and Fouts (1997), who found that firms with higher levels of environmental performance also had better financial performance. However, it was not possible to establish the direction of the causal links, which left open the possibility that firms with better financial performance could afford more environmental protection (see, for example, King and Lenox, Chapter 19, this volume).

Also of considerable influence were the views of Michael Porter, who challenged the conventional view amongst economists that environmental regulation almost invariably inhibited innovation and reduced profitability. In a short but extremely influential essay in *Scientific American*, Porter suggested that 'properly constructed regulatory standards, which aim at outcomes and not methods, will encourage companies to re-engineer their technology. The result in many cases is a process that not only pollutes less, but also lowers costs or improves quality' (Porter, 1991, p. 168). By implication, and more relevant for present purposes, firms that were spurred by regulation in this fashion would ultimately go beyond compliance in the pursuit of competitive advantage. In an essay with Claas van der Linde (Chapter 3), Porter further develops this argument. According to Porter and van der Linde, environmental regulation, which has traditionally been regarded as an impediment to new

environment protection initiatives, will actually act as an incentive to innovation, encouraging companies to gain competitive advantages or cut costs by developing novel methods of reducing environmental problems. Moreover in a second essay (Chapter 4) they argue that it is likely to be in a firm's interests to reduce its consumption of resources and levels of pollution because 'innovation offsets' will justify the costs invested in such a course of action. Firms adopting this approach will save on raw material, energy cost, capital costs, cost of future environmental compliance and much besides. Ultimately implicit in their message, too, is that going beyond compliance will make good business sense.

From a rather different intellectual base, a body of theory known as 'ecological modernization' also took the view that economic and environmental imperatives can be reconciled and that there is considerable potential to increase profits by reducing costs, provided that appropriate policy frameworks are established by government (see generally Mol and Sonnenfeld, 2000). In contrast to many analyses which suggest that a radical reorientation of our current economic and social arrangements will be necessary to avert ecological disaster, ecological modernization suggests that ecologically sound capitalism is not only possible, but also worth working towards. Parts of this literature emphasize how strategies such as eco-efficiency can facilitate environmental improvements in the private sector (particularly in relation to manufacturing) by simultaneously increasing efficiency and minimizing pollution and waste. This will require switching to the use of cleaner, more efficient and less resource-intensive technologies, shifting away from energy and resource-intensive industries to those which are value- and knowledge-intensive, as well as towards anticipatory planning processes, and the 'organisational internalization of ecological responsibility' (Cohen, 1997, p. 109). In contrast to the business strategy literature described above, however, Peter Christoff (Chapter 5) and other leading proponents of this approach, such as Mol and Sonnenfeld (2000), imply that there will be both winners and losers – resource-intensive and highly polluting industries would decline and ultimately collapse to be replaced by others which, while meeting important human needs, did so in ways that were consistent with sustainable development.

Notwithstanding some differences of emphasis, a common refrain of the above accounts was that going beyond compliance was good for both business and the environment, whether this was couched in terms of harnessing the benefits of natural capitalism, in terms of a shift to clean production and product stewardship, or in terms of taking advantage of the incentives for innovation and competitive advantage provided by environmental regulation. The contributions of John Elkington (Chapter 6) as to the benefits of the 'triple bottom line', whereby companies can simultaneously serve social and environmental goals as well as profits, and of Green, Groenewegen and Hofman (2001) on how firms can 'get ahead of the curve' by engaging in environmental innovation were similarly underpinned by a conviction that there were multiple win-win opportunities to be taken advantage of.

In contrast, others argued that if CER was without financial pain, then most businesses would have embraced it by now. Yet, despite the purported benefits which may flow from CER initiatives, relatively few enterprises have engaged in them. Noah Walley and Bradley Whitehead, in a particularly hard-hitting critique, suggest that this is because 'it's not easy being Green' (Chapter 7). Notwithstanding that 'questioning today's win-win rhetoric is akin to arguing against motherhood and apple pie' (p. 121), they provide evidence that win-win situations are very rare and indeed 'insignificant in the face of the enormous environmental expenditures that will never generate a positive financial return' (p. 121). They argue that

the advocates of win–win solutions provide very little practical guidance as to how those solutions can be achieved and that, on closer analysis, only in a small minority of cases are such outcomes likely to be achievable. What is needed is to recognize the tension between environmental spending and profitability and for business to focus on the ‘trade-off zone’, seeking to weigh and balance environmental benefit against the costs involved and to maximize the former while minimizing the latter. For them, the bottom line is that:

For all environmental issues, shareholder value, rather than compliance, emissions, or costs, is the critical unifying metric. That approach is environmentally sound, but it’s also hardheaded, informed by business experience, and, as a result, much more likely to be *truly* sustainable over the long term. (p. 128, emphasis in original)

Their argument receives empirical support from studies which have found that, in some industries, plants with higher pollution-abatement costs experienced lower productivity or that regulation has diverted economic resources and managerial attention away from productivity-enhancing innovation.<sup>2</sup>

Almost all authors contributing to this ‘first generation’ of CER literature, located themselves close to one end or the other of the win–win/win–lose continuum. Either there were numerous win–win opportunities out there but business had not yet discovered them, or they were so few and far between that the entire CER approach offered only a modest variation on the business strategy status quo. Hoffman reminds us of a well-known story of the economist walking with his son. “‘Daddy, there’s a twenty dollar bill on the ground’”. The father replies, “‘It couldn’t be, Son. If there was, someone would have already picked it up by now’”’. (Hoffman, 2000, p. 7). For proponents of win–win there are lots of pieces of paper, most of them being valuable currency. For proponents of win–lose, like the economist in the story, any such pieces of paper will in all likelihood be valueless – perhaps some might have had value at some previous time, when there were lots of ‘low hanging fruit’ in terms of environmental opportunity, but this is unlikely to be the case today.

### **Second-generation CER: Beyond the Win–Win/Win–Lose Dichotomy**

Gradually, a more nuanced ‘second-generation’ CER literature developed which, rather than providing polarized answers to the question as to whether firms could ‘do well by doing good’, saw the answers in shades of grey (or green). Sometimes, in some contexts, environmental spending would reap gains for business, but on other occasions it would be ‘money down the rat hole’. There were lots of pieces of paper on the floor – some were valuable currency and some were not. The percentage that had value would probably vary with the context, and only those with a coherent business strategy would be capable of identifying them.

One question that had not been adequately answered by ‘first-generation’ writers was why, assuming that considerable win–win opportunities do indeed exist (in other words, that even

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<sup>2</sup> For a discussion see Reinhardt (2000), who argues that, in some contexts, beyond-compliance environmental spending can have an adverse economic impact on the firm while in others the converse is the case.

if proponents of this position may overstate the benefits, their basic position is sound<sup>3</sup>), the majority of enterprises had not taken advantage of them. If many win–wins exist, why, has business adopted a position which is, on the face of it, irrational? The most plausible reasons are an emphasis on short-term profits, bounded rationality and opportunity costs.<sup>4</sup>

A focus on short-term profit is probably the single largest impediment to CER (Rappaport and Flaherty, 1991). Unfortunately, many environmental investments will only pay off in the medium to long term, while the upfront investment is primarily short-term. Because public companies are judged by markets, investors and others principally focusing on short-term performance, if they cannot demonstrate tangible economic success in the here and now there may be no long term to look forward to.<sup>5</sup> It may well be no coincidence that many of the business leaders in sustainability initiatives are private, rather than public, companies, like Patagonia, or returned to private ownership, as with Levi-Strauss, and are not driven by the same short-term imperatives. If this is the case, then at least under our present economic system, in which short-termism is paramount, the scope for CER may be substantially constrained.

Bounded rationality may also explain businesses' failure to adopt proactive environmental policies even when it is in their economic interests to do so. Bounded rationality assumes not that people are irrational (although they sometimes are), but rather that they have neither the knowledge nor the powers of calculation to allow them 'to achieve the high level of optimal adaptation of means to ends that is posited by economics' (Simon, 1992, p. 3).<sup>6</sup> For example, it is widely accepted that there are substantial energy efficiency improvements which industry could profitably adopt. However, most firms fail to take advantage of them. Only where energy is a large component of business input costs have substantial investments in energy efficiency been made. In the least energy-efficient industries where energy costs are only a minor component of overall business costs, energy efficiencies have been almost entirely ignored. This is bounded rationality at work: management focuses on core business functions and ignores lesser costs, even though these costs could be reduced through environmentally beneficial behaviour. Equally, business managers may ignore a win–win opportunity because they feel that they could better invest the money elsewhere (the question of opportunity costs)

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<sup>3</sup> See Porter and van der Linde (Chapter 3) and the discussion in Clark (1994). For a more comprehensive critique see Robinson (1995). See also Gunningham (1994).

<sup>4</sup> Broader reasons for failing to exploit the economic advantages of going beyond compliance include: insufficient technical expertise; lack of information; middle management inertia; ignorance of marginal cost curves; insufficient resources to focus on anything other than core business functions; a reluctance to borrow capital; and uncertainty about future returns. See Jacobs (1991) and Gunningham (1994).

<sup>5</sup> Of course, some commitment to environmental priorities will have short-term pay-offs. Improvements in waste reduction, in good housekeeping, in saving energy, in eliminating excessive packaging and even in alternative materials purchase will feed back directly into corporate profits, but even here, while the first 25 per cent improvement may be quite easily achieved, the next 25 per cent may prove far more challenging. Even so, beyond this, the extent to which a firm may be willing to sacrifice short-term profit for long-term dividends will depend on a number of factors. See generally Gunningham (1994, pp. 254–81).

<sup>6</sup> Two factors which undermine rationality are not knowing in advance the desired outcome and not knowing how to achieve the desired outcome even when it is known in advance. Given these constraints on rational behaviour there is an important role for government in providing incentives for firms to go beyond compliance.

or the benefits may not be sufficient to outweigh other corporate priorities (see Greer and van Löben Sels, Chapter 8).

These sorts of complexities gradually engaged CER researchers and analysts, and the debate about CER evolved to a more sophisticated level in which much deeper questions were asked about whether, to what extent and when it made sense to 'go green'. One of the most influential of the second-generation CER analysts was Forest Reinhardt, who, in a series of essays (see Chapters 9 and 10) and in his book *Down to Earth* (2000), sought to specify in much more qualified and nuanced terms the relationship between corporate environmental spending and the bottom line and to refine the set of circumstances under which investing in CER would credibly provide strategic advantage. He explored, for example, whether or under what circumstances firms might be able to differentiate products along environmental lines (for example, where there are barriers to entry and mobility in the industry), whether some oligopolistic firms might be about to use regulation to strategic advantage (as when Du Pont, with an advantage in new technology to replace CFCs, lobbied for the latter to be outlawed via the Montreal Protocol), and when the voluntary provision of public goods might be a sensible risk-management mechanism (for example, where there is information asymmetry) (p. 180).

Rejecting 'one size fits all' solutions Reinhardt argues that it will make sense for a firm to pursue 'beyond compliance' environmental policies, but only if they increase the firm's expected value or appropriately manage business risk. Much will depend on 'the structure of the industry in which the business operates, its position within that structure and its organizational capabilities' (p. 180). Only by developing a sophisticated environmental strategy and identifying the fundamental business logic that underlies successful corporate environmental policies will it be possible for firms to turn environmental strategy into competitive advantage.

Yet one central question remained unanswered, notwithstanding Reinhardt's considerable contribution to the CER debate. Just how broad were these specific opportunities to combine environmental spending with bottom-line benefits? CER sceptics remained, although in the 'second-generation' debates, they brought to bear a much better informed empirical analysis and more refined arguments than their 1990s predecessors. Most notably, David Vogel, in his book, *The Market for Virtue* (2005a), in his essay in this volume (Chapter 11) and elsewhere (Vogel, 2005b, 2005c), argued not that CER is a myth, but also that the circumstances in which it is likely to be a viable business strategy are seriously circumscribed. For example, he suggests that it is very difficult to differentiate one's products on the basis of their environmental credentials both because barriers to entry are low and because the market in many areas is saturated. Confronted with a bewildering variety of different products, most consumers with regard to most products seem not to care:

Most consumers are unaware of, and indifferent to, where, how and by whom the vast majority of products they consume are made. The most prominent 'ethical' label in the United States – Fairtrade coffee – has a market share of less than 1 per cent, and boycotts and protests have not measurably affected sales or share prices of other brands. While the assets of ethical mutual funds have grown substantially, they still make up only 2 per cent of mutual fund assets in the United States (Vogel, 2005c).

Vogel also argues that companies that fail to align their CER initiatives with their broader business strategy – particularly those which invest in CER when this is inconsistent with

their business plan – will achieve little or nothing by doing so. This is because consumers and others will see the disconnect and be unconvinced of the company's sincerity. Yet he also suggests that this dilemma can sometimes be avoided. Wal-Mart, for example, shifted to CER (through initiatives to cut energy use and bring supply chain pressure to bear to ensure fuel efficiency) in a manner that was entirely consistent with its broader business plan. The company has achieved massive market gains by reducing prices and cannot afford to raise wages without abandoning this strategy. On the other hand, it can make reputational gains through developing its environmental credentials without threatening the success of the basic business model.

Vogel's bottom line is that CSR generally and CER in particular do matter, but they are not critical issues and certainly not central to business strategy. Unfortunately, as he argues in Chapter 11,

... there is no evidence that behaving more virtuously makes firms more profitable ... [and therefore, in the absence of] a business case for CSR, firms will have fewer incentives to act more responsibly. Conversely, the fact that CSR also does not make firms *less* profitable means that it is possible for a firm to commit resources to CSR without becoming less competitive. In brief, there is a place in the business system for responsible firms, but the market for virtue is not sufficiently important to make it in the interest of all firms to behave more responsibly. (p. 186)

Vogel's general position finds support from a variety of commentators, *The Economist*, for example, has suggested that the greatest failing of CSR is that 'it focuses on relatively trivial action by companies at the margins of their businesses rather than substantial action at the cores' (Crook, 2005, p. 4). For most conventionally organized public companies – which means almost all of the big ones – CSR is little more than a cosmetic treatment. The human face that CSR applies to capitalism goes on each morning, gets increasingly smeared by day and washes off at night' (Crook, 2005, p. xx).

Yet this more sceptical view is no more accepted by proponents of CER in its second-generation manifestation than it was in its previous incarnation, and CER advocates continue to provide a stream of 'good news' stories and case studies in support of their more optimistic perspective. While these accounts, too, tend to be more refined than their first-generation predecessors, draw from a broader range of case studies and are less reliant on anecdotal evidence, the basic message remains much the same. For example Esty and Winston in their 2006 book, *Green To Gold: How Smart Companies Use Environmental Strategy to Innovate, Create Value and Build Competitive Advantage* (2006), argue that a 'green wave' is sweeping the corporate world. Smart companies see this wave coming and identify means to profit from it. Amongst other strategies, this might involve cutting costs, reducing risk, increasing revenues and creating strong brands. This, Esty and Winston emphasize, is not to suggest a crude 'one size fits all' approach. On the contrary, the precise strategy should depend on the context. But provided they are strategically designed, then environmental initiatives can turn environmental pressures into strategic advantage. Consistent with this, in Chapter 12 Thomas Dyllick and Kai Hockerts argue that there are six criteria – eco-efficiency, socio-efficiency, eco-effectiveness, socio-effectiveness, sufficiency and ecological equity – that managers aiming for corporate sustainability will have to satisfy, and that how these criteria might best be met will vary with the context.

However, these second-generation proponents of CER do acknowledge that, so far, wide-reaching environmental initiatives have not been widely embraced by business. The position of these writers is rather that leading corporations and CEOs have seen the light and are proceeding down this path, and that a range of others can and should follow. In the language of business strategy, leaders and fast followers see strategic advantage in CER. However, whether team players, compliance-seekers and laggards will do so in the future remains an open question. For the moment, proponents prefer to extol the virtues of environmental leaders and how they have benefited from this strategy while implying that these companies provide an example that others can follow.

Thus Esty and Winston point to the CER initiatives of global corporations such as General Electric, Toyota and Dow which, they argue, have already reaped very considerable financial gains by pursuing such a strategy, but they do not suggest that the approach of these corporations is representative. Similarly Chris Laszlo, in *Sustainable Value: How the World's Leading Companies are Doing Well by Doing Good* (2008), claims that:

A small but influential group, they are now reinventing the role of business in society. They are shifting the focus away from minimizing negative impacts (such as brutally downsizing employees or unintentionally contaminating soil and water) to offering new solutions to global problems that the public sector has been unable to tackle alone. (Laszlo, 2008, p. 21)

This is also the theme of Andrew Hoffman's *Carbon Strategies: How Leading Companies Are Reducing their Climate Change* (2007), which shows how multinational companies have incorporated carbon reduction initiatives into their business plans for reasons of both environmental risk and opportunity. But, either implicitly or explicitly, these writers believe that what leading companies are doing now, others can and should do later. Thus for Laszlo:

In this new competitive environment, societal challenges such as climate change or the alleviation of global poverty are not only risks, but huge business opportunities, *not only for niche players but for mainstream business*. (Laszlo, 2008, p. i, emphasis added)

Leading companies themselves have, both individually and through their associations, gone on record to support such views. For example, in the lead-up to the Johannesburg environmental summit in 2002<sup>7</sup> some influential business leaders formed the World Business Council for Sustainable Development to facilitate the dialogue with politicians about means of achieving sustainability. In the follow-up, *Walking the Talk*, a 2002 book by Halliday, Schmidheiny and Watts, argued that business leaders should pay far more attention to the opportunities for 'eco-efficiency'. This might be achieved by dematerialization (for example, substituting knowledge flows for material flows and customizing products so that less waste is created), production loop closure (working towards closed-loop production and zero waste), service extension (for example, supplying product services and leasing durable goods rather than selling them outright) and functional extension (as through the manufacture of 'smarter' products with enhanced functional value).

Others, well-known contributors to the first generation of CER literature have refined and sometimes extended their contributions in their more recent publications. For example, Michael

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<sup>7</sup> United Nations World Summit on Sustainable Development, Johannesburg, 2002. See [http://www.un.org/jsummit/html/basic\\_info/basicinfo.html](http://www.un.org/jsummit/html/basic_info/basicinfo.html) (accessed 1 February 2008).

Porter, an influential first-generation figure, has restated his own position (with Mark Kramer) in an essay on the link between competitive advantage and corporate social responsibility (Chapter 13). Porter and Kramer emphasize not just the direct financial advantages but also the intangible benefits of CSR and CER: better reputation, higher employee morale and competitive advantage in attracting high-quality employees. They also point out that prevailing approaches too frequently fail because they are:

... so fragmented and so disconnected from business and strategy as to obscure many of the greatest opportunities for companies to benefit society. If, instead corporations were to analyze their prospects for social responsibility using the same frameworks that guide their core business choices, they would discover that CSR can be much more than a cost, a constraint or a charitable deed – it can be a source of opportunity, innovation, and competitive advantage. (p. 226)

Notwithstanding that the second-generation CER literature is more sophisticated and nuanced than its predecessor, there are two striking continuities between first- and second-generation writings. First, the very large majority of analyses are couched in pragmatic terms and concerned with the question of whether, to what extent and in what circumstances it makes strategic sense to invest in CER – whether, in effect, it is possible to do well by doing good. Altruism, ethics and morals are rarely given serious consideration. Second, there is limited empirical support for the various positions espoused. Certainly second-generation studies are better empirically informed than the earlier, largely anecdotal, accounts of CER, but which sorts of companies or industry sectors are engaged in what sorts of CER, or what proportion of business has embraced CER, or why some companies engage in CER initiatives while other, similarly placed companies do not, are large silences within the literature. Both these limitations are examined in the following sections.

### **Ethics, Altruism and the Business Case for CER**

What does it mean to be a good corporate citizen? Lacking in both the first- and second-generation CER literature is any serious exploration of whether there is any ethical obligation for corporations to behave in any particular way towards the environment and, if there is, what this might involve. Some writers are content to suggest that legal obligations represent society's moral barometer and that, provided companies are legally compliant, they have discharged all implied ethical obligations. Others, following Milton Friedman, suggest that it would be improper for corporations to spend money engaging in altruistic behaviour (for example, environmental spending which will eat into profits) because this is contrary to their fundamental obligations towards their shareholders. Consistent with this, in Chapter 14 Paul Portney points out that spending on CER may divert private corporations from the very purpose for which they were created – 'to provide goods and services to consumers under protection of limited liability' (p. 255) – reallocating resources that could be better used to earn competitive returns. Similarly, Porter and Kramer argue that '[b]y providing jobs, investing capital, purchasing goods, and doing business every day, corporations have a profound and positive influence on society' (p. 235).

Certainly, as Archie Carroll argues in Chapter 15, the CER literature is not entirely devoid of those arguing for an ethical component to environmental spending. The leading

CSR business association in the United States, Business for Social Responsibility, exhorts its members to ‘achieve commercial success in ways that honor ethical values and respect people, communities and the natural environment’ (BSR, 2003), and the World Business Council for Sustainable Development in its 1999 report, *Corporate Social Responsibility: Meeting Changing Expectations*, argues that environmental ethics and business profitability can go hand-in-hand because:

... a coherent corporate social responsibility strategy based on sound ethics and core values offers clear business benefits. These accrue from the adoption of a broader world view, which enables business to monitor shifts in social expectations and helps control risks and identify market opportunities. Such a strategy also helps to align corporate and social values, thus improving reputation and maintaining public support. (World Business Council, 1999, p. 2)

It is also entirely plausible that some beyond-compliance activity by corporations may be motivated by a managerial responsiveness to environmental values. Corporate officials and employees, after all, are not immune to the sentiments and norms that pervade their social and political environments. The CEO who takes holidays in the outdoors may come to care deeply about the integrity of ecosystems and seek to use his or her corporate power as beneficently as possible. A study of nursing-home regulation found that regulated enterprises’ attitude *and sense of social responsibility* were stronger predictors of compliance than their perceptions of the likelihood of legal detection and punishment (Braithwaite and Makkai, 1991), and one might expect similar results with respect to environmental regulation, at least for some companies.

More broadly, the ‘new institutionalism’ theories of organizational behaviour –although rarely directed at CER (see Hoffman, 1997) – suggest that:

... institutional factors often lead organizations to conform to societal norms even when formal enforcement mechanisms are highly flawed. Frequently cited institutional influences include historical legacies, cultural mores, cognitive scripts and structural linkages to the professions and to the state. Each, in its own way, displaces single-minded profit-maximization with a heightened sensitivity to the organization’s embeddedness within a larger social environment. (Suchman and Edelman, 1997, p. 919)<sup>8</sup>

Nevertheless, most of the CER literature maintains that there are firmly pragmatic reasons why firms can and do go beyond compliance, couched in the language of ‘win-win’ outcomes and doing well by doing good. Like the CSR literature more generally,<sup>9</sup> it suggests that the large majority of those committing additional resources to CER do so because they are convinced of the ‘business case’ for going beyond compliance. Many of these accounts, as described above, focus on the financial advantages to be gained from reducing pollution, energy efficiency or environmental innovation.

But others, such as Edmund Burke (Chapter 16), couch the business case in terms of risk management and reputation capital. For example, the mining sector perceives the business case for CER as being based on competitive advantage and reputational enhancement (Walker and Howard, 2002; Yakovleva, 2005). Similarly, large chemical companies suggest that they

<sup>8</sup> See also Hoffman (1997).

<sup>9</sup> For a useful overview see Vogel (2005a). See also Reinhardt (2000).

usually go beyond compliance for reasons related primarily to the perceived need to protect their reputation and maintain the trust of local communities (Gunningham, Thornton and Kagan, 2005). Indeed, in almost all reputation-sensitive sectors of the economy, the predominant focus of the business case for CER is risk management, the principal driver being the fear that, without taking measures to protect one's reputation, communities, ENGOs, regulators or others may take action which will adversely affect the corporate bottom line (Reinhardt, 2000, Ch. 6).<sup>10</sup> Hence, as noted by Frances Bowen in Chapter 17, many corporations take measures that are not legally mandated in order to avoid adverse publicity or to win the support of environmental or social activists in their home communities.

Sometimes, too, firms go beyond compliance because they feel it is 'good business' to develop co-operative and mutually trusting relationships with regulatory officials. Not infrequently, groups of firms have institutionalized voluntary self-regulatory plans more stringent than those required by law in the hope of warding off the possibility of more intrusive and less flexible governmental regulatory initiatives. And, quite commonly, firms that are investing in new production facilities or pollution abatement systems 'over-comply' with current regulatory demands so that anticipated future tightening of regulatory requirements will not compel them to make costly retrofits.

The above account of the (entirely pragmatic) reasons why corporations engage in CER initiatives leads to a fundamental observation: if CER is engaged in almost entirely because there is a 'business case' for doing so, then how is it different from 'ordinary' profit maximization (Portney, Chapter 14; Reinhardt, 2005)? As Portney puts it, 'if a firm's investments in CSR are defended on grounds of profitability, what is so socially responsible about that? (p. 258)' Indeed, although the entire CSR debate was sparked by what some saw as an extreme pragmatic position put by Milton Friedman, ultimately, Friedman would have little objection to current profit-maximizing CER initiatives.

### **How Real is CER? What the Evidence Tells Us**

What proportion of corporations has actually been persuaded to go beyond compliance and engage in CER, to what extent and in what circumstances? How substantial has the overall shift in corporate attitudes and behaviour towards the environment been? Has the new win-win rhetoric permeated corporate boardrooms and produced any substantial change in industry environmental practices? Has any such movement been uniform, or have some corporations and some sectors become much greener than others? How far beyond compliance are firms willing to go? Is CER real or little more than an illusion? Existing research points to some interesting trends, but does not provide any systematic answers.<sup>11</sup>

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<sup>10</sup> Note that Vogel argues that, 'There *is* a business case for CSR, but it is...best understood as a niche rather than as a generic category: it makes business sense for some firms in some areas under some circumstances' (Vogel, 2005a, p. 3).

<sup>11</sup> For example, many studies in this area are largely descriptive and exploratory and focus on leaders rather than the variation between leaders and laggards. See, for example, Shrivastava and Scott (1992). Others confine themselves to survey evidence or are very preliminary in nature. See, for example, Tsai and Child (1997). For a broader analysis of the limitations of existing research see Fuchs and Mazmanian (1998).

Various indirect indicators of environmental strategy suggest that a sea-change in corporate attitudes towards the environment may indeed be taking place. There is increasing evidence of (1) application of 'total quality management' and 'continuous improvement' strategies to corporate environmental management; (2) voluntary environmental audits and ecological life-cycle analysis of inputs, products, and wastes; (3) environmental cost accounting; and (4) industry association-led environmental management certification plans. Corporate officials have increasingly adopted the rhetoric of win-win outcomes and competitive advantage.<sup>12</sup> Yet whether or to what extent they are 'walking the talk' in terms of CER is not known. Reviewing the limited evidence on the effect of formal environmental management systems, such as ISO 14000, Jennifer Nash and John Ehrenfeld conclude:

Firms that see environmental practices as marginal to their strategic and competitive objectives will treat EMSs as tools for external image manipulations and unimportant for internal change. Firms with strong environmental commitments will use EMSs as tools to become even stronger. (cited in Coglianesse and Nash, 2001, p. 79)

As to why firms develop various environmental management strategies there are a diversity of views, the most credible of which are based on substantive empirical research (see Prakash, Chapter 19 and King and Lenox, Chapter 20). Some commentators, particularly those within the 'greening of industry' network, have suggested that business strategy commonly evolves through a number of stages as companies become progressively more environmentally conscious, with the leaders positioning themselves substantially beyond compliance with existing regulatory requirements (Newman, 1993; Winsemius and Guntram, 1992; Roome, Chapter 20; Greeno, 1991; Hunt and Auster, 1990). For example, Newman (1993) suggests three stages in corporate development – reactive, proactive and innovative – each representing a particular attitude to environmental risk and responsibility (for example, reactive companies focus on risk, innovative ones on opportunity). And Nigel Roome, in what is probably the most widely cited of the numerous models so far developed (Chapter 20), has postulated a scale of environmental strategies ranging from non-compliance to compliance to compliance, as well as to leading edge/excellence.

The stage models, however, have simply assumed (or, in some cases, exhorted) an evolution towards excellence, suggesting that once companies begin to pursue a high level of environmental performance (with attendant economic gains), this behaviour will develop its own momentum,<sup>13</sup> 'propelling a company along a continuum towards excellence, albeit by necessity, over time' (Ghobadian *et al.*, this volume, p. 337). On the other hand, Schaefer and Harvey (Chapter 26) concluded from a series of case studies that the 'stage model' of

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<sup>12</sup> For example, in a McKinsey survey, 92 per cent of CEOs and board members stated that the environment should be one of their top three management priorities, and 85 per cent claimed that one of their major goals should be to integrate environmental considerations into business strategy (Walley and Whitehead, pp. 125–25, this volume). See more generally the initiatives and publications of the Global Environment Management Initiative (GEMI) at: <http://www.gemi.org>.

<sup>13</sup> Hoffman (1997) draws on the 'new institutionalism' literature in organizational behaviour to argue that corporations tend to emulate the organizational structures and practices of the most economically and politically successful entities in their 'organizational field', finding that petroleum and chemical companies have followed a similar evolution of environmental practices in the past three decades.

corporate greening fitted the facts poorly and that ‘more comprehensive, in-depth accounts of organizational “greening” are needed (p. 446). A. Ghobadian and colleagues (Chapter 21) found that:

... the UK corporations in this sample recognize the importance of developing effective environmental policies, but ... the motivation for policy development is primarily reactive and dependent upon the expected development of environmental legislation. There appears to be little strong evidence of companies actively seeking environmental leadership. (p. 339)

Their overall conclusion is that ‘[a]lthough there is considerable enthusiasm for a proactive environmental stance in the literature, this message appears to have reached just a few large organizations and even fewer SMEs’ (p. 339).

Most of the empirical evidence that does support the proposition that corporations are now moving ‘beyond compliance’ and engaging in CER initiatives comes from case studies of a very few individual firms or multisector studies of environmental leaders. For example, Prakash’s detailed study of environmental policy decisions at Eli Lilly and Company and Baxter International Inc. found that, on some issues, both companies did indeed make large expenditures on environmental improvement measures that went well beyond compliance (Prakash, 2000). Furthermore, Prakash found that Lilly and Baxter instituted some beyond compliance environmental policies even though those expenditures did not meet well-defined criteria for *ex ante* assessment of their contribution to firm profits:

[P]olicies on underground tanks, the 33/50 program and Responsible Care were initially opposed by some managers since they do not meet formal profit criteria. Over time, however, policy supporters succeeded in convincing policy skeptics that these policies indeed serve the long-term interests of their firms, although their profit contributions cannot be quantified. (Prakash, 2000, pp. 138–9)

Yet one might legitimately wonder whether those beyond compliance efforts by Lilly and Baxter, two very successful multibillion-dollar companies, are typical. Overall, only 13 per cent of eligible US firms and only 64 per cent of the 600 largest corporations signed up for the EPA’s beyond-compliance 33/50 programme (Prakash, 2000, p. 135). In a study of over 100 US-based corporations, including intensive study of 30 thought to incorporate ‘best practices’ in their environmental management systems, Marc Epstein found that, while many companies often thought to be the worst polluters are progressing rapidly, most firms have a ‘compliance orientation rather than a planning orientation for environmental impacts’ and there is surprisingly little functional cooperation between environmental and other departments (Epstein, 1996, p. 239).

A survey of corporations in Germany was similarly negative about the extent of CER ‘on the ground’ (Steger, 1993), and Robert Shelton, director of the consulting company Arthur D. Little notes in Chapter 22:

While some companies are successfully moving ahead with reliable strategic environmental management initiatives, others are repositioning or backing away ... Why? Because they have hit the ‘Green Wall’. ... Symptoms ... include negative or deferred decisions due to a lack of management support ... and the inability to demonstrate to others in the organization attractive returns on further investments in the environmental programs. (pp. 349–50)

This conclusion resonates with the argument put forward by Noah Walley and Bradley Whitehead in Chapter 7 above that win–win environmental investments have become harder to find and have been oversold, and that the economic costs of making really significant environmental gains are likely to be quite high.

Clearly (and contrary to the assumptions of much of the business and environment literature),<sup>14</sup> while investment in beyond-compliance CER measures is a very real phenomenon, it is also variable. So, how can that variation be explained? Why do some companies take the beyond-compliance path and others decline to do so? Why do companies do so for some measures and not for others? As we shall see, no concise answer emerges from the existing research.

### Explaining Variation in CER

Some of the literature on corporate environmental management implies that managerial attitudes and leadership are the key factors in determining the level of a corporations' investment in beyond-compliance measures (Hirshhorn and Oldenburg, 1991), although much of this is speculative.<sup>15</sup> An empirical analysis of the greening of accounting concludes, for example, that:

... at an intuitive level, our inference is that the degree of response of the company depends upon the attitudes of the senior management, their responsiveness to employee, community and peer/business opinion and the extent of the pressure they experience from their holding company or the stock market ... typical factors like size, industry, country of operations or ownership or consumer orientation appeared to have little or no effect in attempting to distinguish between level of response by companies. (Gray *et al.*, 1995, p. 224)

Similarly, it has been suggested that management may play a crucial role in influencing how various environmental management tools will be deployed and how effective they will be. For example, while the adoption of environmental codes of practice and environmental management systems might serve to embed various environmental practices (see, for example, Florida, Atlas and Cline, 1999) and 'lock in' cultural change, continuous improvement and CER, it is by no means clear that they can do so in the absence of committed environmental management. Jennifer Nash's study of 16 firms participating in the chemical industry's Responsible Care programme lends substance to such speculations (Nash, 2000). She found that participation in Responsible Care dramatically changed the way of thinking of three of the firms and was a useful and important safety health and environment tool in another three. But in ten of the firms, Responsible Care did not significantly change internal behaviour. This suggests that corporate managerial commitment may play a key role in determining whether environmental management systems or codes of practice have a real impact on performance.

What is it about management that may either facilitate or impede CER? According to the literature on corporate management, a crucial variable in this regard is whether senior corporate managers perceive environmental protection issues as a potential opportunity or as a

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<sup>14</sup> See, for example, Baylis, Connell and Flynn (1998), noting at p. 153, the 'widespread generalization that industry is homogeneous in its response to [external] demands'.

<sup>15</sup> This in turn connects directly to the broader literature concerned with the management of corporate change. See, for example, Peters and Austin (1985); Schein (1992).

threat.<sup>16</sup> There seems to be no right answer: advocates of the opportunity viewpoint argue that companies in jurisdictions with higher performance standards reap a competitive advantage or are at least at no competitive disadvantage,<sup>17</sup> while others hold that plants in more stringently regulated jurisdictions will be at a competitive disadvantage.<sup>18</sup> Hence management attitudes in this regard clearly matter. But what is never adequately answered by this literature is *why* some managers adopt the first perspective while others adopt the second.

In any event, some theorists argue that the key to corporate CER is individual environmental leadership at the top executive level. For example, Thomas Gladwin (Chapter 23) argues that in view of ‘inertial forces impeding adaptation toward greening’ (p. 372), it takes ‘charismatic green leadership’ (p. 374) – defined as including a force of personality capable of inducing a high degree of loyalty, commitment, and devotion to the leader – to bring about proactive corporate environmental greening (see also Ghobadian *et al.*, this volume, p. 341). For Richard Daft, too, significant corporate greening depends on ‘transformational leadership’ whereby management teams are motivated by inspired leaders to ‘believe in the vision of corporate transformation, to recognize the need for revitalization, to sign on for the new vision, and to help institutionalize a new organizational process’ (Daft, 1992, p. 468). But while such leadership may be important, it is not obvious why it emerges in some situations and not in others, or whether leadership alone could bring about far-reaching change in corporate policy. Accordingly, others have looked outside the corporation for satisfactory explanations of why some corporations, but not others, have moved beyond compliance.

### *The Corporation's External Environment.*

Many scholars have emphasized the explanatory power of factors in the business corporation's external political, legal and economic environment.<sup>19</sup> In his study of environmental policies in German corporations, Ulrich Steger (Chapter 24) concludes that the extent to which a company is aggressive and innovative in adopting proactive environmental policies (which may lead to beyond-compliance outcomes) is determined by two ‘external’ variables: first, the intensity of the *environmental risks* inherent in the company's operations (which are assumed to correlate with *the level of regulatory and public scrutiny*); and, second, *market opportunities* which the firm can derive from innovations in environmental protection.

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<sup>16</sup> Opportunity: Porter and van der Linde (1995); and Estrada, Tangen and Bergeson (1997). Threat: Walley and Whitehead (Chapter 7, this volume).

<sup>17</sup> Some managers clearly share this point of view. In a comparative study, officials in two Japan-based multinational manufacturing companies asserted the view that worldwide environmental standards probably will become steadily more stringent over time: their firm, therefore, sought to gain a competitive advantage by becoming a leader in developing technologies and management systems for reducing pollution. See Aoki and Cioffi (2000); Aoki, Kagan and Axelrad (2000).

<sup>18</sup> For a brief review of the literature, see Sanchez (1997).

<sup>19</sup> For example, Yosie's and Herbst's study on how corporations are integrating business methods with environmental management lists as the main motivators of excellence: economic benefits; corporate commitment and values; reputation enhancement; regulatory requirements; customer and stakeholder expectations; the contribution of EHS issues toward strategic differentiation of the company; and improved employee relations. Of these, only corporate commitment and values can be classified as an internal, rather than an external, driver. See Yosie and Herbst (1997).

The implication is that when a corporation's current environmental performance does not pose significant legal and reputational risks, and improvements, perhaps because they are very costly, do not appear to offer a win-win economic advantage of the 'green-gold' type discussed by Porter and van der Linde in Chapter 4, then one would not expect to see the firm investing in CER initiatives or even taking a strongly aggressive stance towards maintaining legal compliance.<sup>20</sup> Conversely, in Steger's model one would expect innovative corporate policies when the environmental risks that a firm's operations generate (and hence the legal and/or reputational risks it faces) are great, or when the firm clearly can make money by going beyond compliance in certain ways. But that theory does not tell us how far a firm is likely to go in reducing external risks when risk-reducing environmental measures will be very costly and unprofitable. And it assumes that both risks and opportunities are self-evident, so that different corporate managements presumably would respond in the same way to a particular external environment.

Prakash (2000, p. 150) found that external variables were indeed important in shaping Eli Lilly's and Baxter International's incentives to invest in expensive beyond-compliance measures. One such variable is local community concern and pressure. Companies respond to such pressures partly because managers and employees who live in the community commonly are sensitive to their families' and neighbours' concerns and partly because local dissatisfaction might trigger tighter political and legal constraints on company operations. A study of pollution control in 26 pulp and paper mills in Bangladesh, India, Indonesia and Thailand (Hartman, Hug and Wheeler, 1997) also emphasizes the importance of community pressure: the nine facilities (mostly in rural communities) that experienced complaints and pressure from local communities were found to undertake significantly more thoroughgoing abatement activities, even when formal regulatory requirements or enforcement were not significant factors. The intensity of local community pressure, as a driving factor, might be assimilated to Steger's emphasis on the intensity of environmental risks or the level of public scrutiny that the facility generates. But community pressure does not always relate to objective risk, for economically dependent, or less-educated, communities sometimes fail to take effective action against serious environmental risks (Foster, 1998; Morag-Levine, 1994).

Scholars also have pointed to another external variable: the intensity of the individual firm's economic stake in maintaining a reputation for good environmental citizenship. Different authors, however, have emphasized different facets of corporate concern for their reputation. According to Prakash (2000), managers in Baxter and Lilly pushed for participation in the 33/50 programme on the grounds that it would help their firms' reputation with the EPA, whose adversarial approach to enforcement they had come to regard as threatening; here, the firms' reputation with regulators was important, and hence the 'driver,' to use Steger's term, was the level (or character) of regulatory scrutiny. Yet one suspects that Baxter and Lilly, highly visible manufacturers of health-care products, were also concerned about their reputation for reliability and integrity with their customers' health-care providers and ultimate consumers. Companies with widely recognized consumer brand names often seem especially

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<sup>20</sup> Thus in a survey of 78 of the largest companies in the UK, Ghobadian *et al.* (Chapter 21) were told that specific requirements regularly set by customers were granted precedence if they conflicted with the company's environmental policy. In our study, too, pulp and paper mills have generally been unwilling to cut use of bleaching chemicals when customers insist on bright white paper.

concerned about their reputation for good environmental citizenship. Thus some authors have theorized that companies are more likely to pursue environmental leadership strategies when they are particularly vulnerable to campaigns that seek to organize consumer boycotts of environmentally damaging products, or when consumers have displayed a market preference for those perceived to be environmentally benign. Similarly, some scholars have focused on environmental visibility as a trigger for corporate reputational sensitivity and as a predictor of green organizational response (see Bowen, Chapter 17). (In these studies, the corporate economic stake in maintaining a reputation for good environmental citizenship is simply a more specific aspect of Steger's emphasis on environmental risk and level of public scrutiny as an external driver of corporate environmental performance). Reinhardt (2000), in exploring whether or to what extent 'it pays to be green', emphasizes Steger's market opportunity variable, highlighting the importance of industry structure, a firm's competitive position and the opportunities that a firm has to differentiate its products on environmental grounds (for which its general environmental reputation will be crucial).

Corporations also are influenced, according to scholars who advance 'new institutionalist' models of organizational behaviour, by what other, perhaps more successful, firms are doing on the environmental front. In many ways, corporations model themselves on others in order to enhance their social, political and economic legitimacy (Suchman and Edelman, 1997). As a consequence of institutional isomorphism, 'organizations adopt many practices and structures not for efficiency reasons but because the cultural environment constructs adoption as being the proper, legitimate or natural thing to do' (Ibid., p. 919). Thus, as Benjamin Cashore and Ilan Vertinsky explain in Chapter 25, if successful competitors are adopting widely publicized environmental management plans or technologies, this increases the pressure for all firms in the same industry or community to follow suit (thereby *reducing* variation). The widespread adoption of ISO 14000 formal environmental management plans by large western European and Japanese manufacturers provides one example; US firms, operating in a different corporate and regulatory culture, have been much more reluctant to do so (Delmas, 2001). Finally, a more pessimistic body of literature holds that firms may be prevented from moving ahead of the pack on environmental matters by a powerful industry association. For example, an industry association may seek to maintain a common industry position – such as that totally chlorine-free pulp has no environmental advantages – and then impose this view on firms that would prefer to take a different position.<sup>21</sup> In this view, if any industry member seeks to claw its way towards environmental leadership or to market its 'green' credentials, the others will yank it back down to the lowest common denominator position (see, for example, Harrison, 1999).

### *Intra-Organizational Factors*

Prakash (2000) argues, quite plausibly, that external factors are a necessary, but not a sufficient, determinant of corporate environmental investment decisions. Risks and opportunities, he found, were interpreted differently by different managers within the same firm. The relative

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<sup>21</sup> The industry association position can be maintained either by direct economic pressure (companies that sell their pulp to other industry members can be threatened with a boycott) or by moral pressure ('if we let them pit us against each other on environmental issues, where will it all end?').

skill of project proponents and sceptics in building supportive coalitions, as well as the attitudes of top management, were crucial in moulding each company's responses to various issues. He found that another important variable was the extent of change that a proposed environmental measure would impose on existing organizational routines and power relationships, making it easier for proponents to push for incremental rather than revolutionary shifts. And Gray and Shadbegian (1998) note that the most commonly given reasons for adopting a green strategy related to enhancing, developing, or protecting the core of the organization as a continuing conventional business.

Many other studies have shown a strong correlation between corporate size and responses to environmental and other regulatory challenges, suggesting that intra-corporate resources (both financial and human) and concern about external reputational sanctions are important factors in producing beyond-compliance investments (Haines, 1997; Hartman, Hug and Wheeler, 1997). Most notably, Florida, Atlas and Cline (1999) have produced empirical evidence suggesting that organizational resources and *organizational monitoring systems* are particularly important in the adoption of environmental innovations.

Other scholars have emphasized such internal factors as an organization's capacity to learn, its general operational control, its organizational structure and the amount of spare management capacity, arguing that these factors may limit the strategies and tactics that are available. Anja Schaefer and Brian Harvey (Chapter 26) write:

Such internal factors can explain a large proportion of the differences we found in the details of environmental management in the companies studied. Companies with the greatest learning capacity and that are most aware of the emergent, processual aspects of environmental strategy may have greater success in adapting to the external pressures for greater environmental sensitivity. (p. 445)

In their view, future research should look at the way in which organizations acquire knowledge, how it is distributed through the organization, how it is interpreted by organizational actors and how it passes into organizational memory.

#### *Interaction of Internal and External Factors*

In his widely cited essay on environmental management strategies, Roome (Chapter 20) argues that the extent of a company's commitment to CER (as measured by 'beyond compliance' behaviour) is influenced by a combination of external pressures and internal variables. Paramount among the former are regulatory demands and liability risks, market opportunities and constraints, and broader stakeholder pressures. But Roome argues that managerial attitudes also play an independent mediating role. Managerial inertia can lead to non-compliance. A reactive managerial stance will focus the facility's efforts on legal compliance alone, whereas it takes a forward-thinking approach to turn those external factors into 'compliance plus' and a truly strong orientation to quality and commitment to innovation to produce environmental excellence.

For Ghobadian *et al.* (Chapter 21), in addition to external pressures/opportunities and managerial attitudes, an enterprise's environmental policies are also likely to be shaped by 'moderating' (that is, constraining) factors relating to a company's *ability* (human skills, financial resources, flexibility) to pursue a more ambitious environmental direction. They argue that such factors:

... intervene between the external pressures and the capability of the company to address the activities necessary to develop successful strategic environmental policies. The mediating factors fundamentally establish the interpretative framework that informs the decision-making process. (pp. 340–41)

Based on a case study of waste management and reduction in a large US chemical company, Peter Cebon (Chapter 27) found that the extent of proactive (that is, 'savings-oriented,' rather than legally required) waste-reduction efforts depended on the skill and determination of in-house waste-reduction managers, who had to find ways of making their proposals attractive to production managers, shopfloor operators, or both.

### **Towards an Interactive Model of CER**

Neil Gunningham, Robert Kagan and Dorothy Thornton in their essay, 'Social License and Environmental Protection: Why Businesses Go Beyond Compliance' (Chapter 28), argue that to explain how companies behave in environmental terms, it is useful to view them as simultaneously motivated and constrained by a multifaceted 'licence to operate'.

Traditionally, the notion of a business's 'licence to operate' referred only to the company's legal obligations. For example, in order to operate legally, a pulp mill manufacturer not only had to obtain a land-use and a construction permit before building a new facility, but also had to introduce particular pollution control technology, and, once operating the facility, it had to maintain certain process and performance standards (for example, concerning hazardous waste disposal and workplace safety). Together, these regulatory obligations and permits might be referred to as a facility's legal or regulatory licence.

Today, however, the concept of 'licence to operate' must include 'economic reality' requirements such as the need to maximize shareholder return on investment (or at least to provide a reasonable rate of return). Of course, the terms of this economic licence of what is an adequate rate of return on investment or level of profitability are not written down in detail as with a regulatory permit. Moreover, they may vary over time, 'tightening' and 'loosening' with market conditions and each firm's economic performance.

In addition, the 'licence to operate' concept has been extended to include the demands of social actors. Neighbours may complain about odour, local and international environmental groups may demand the use of less hazardous bleaching chemicals, and both groups may threaten a variety of informal sanctions if industry fails to respond. An extremely serious violation of community expectations such as a death-dealing explosion in a mill or a chlorine leak that results in severe threats to human health or to severe ecological damage can trigger political demands to close the plant down.

Regulatory, economic and social licences are monitored and enforced by a variety of stakeholders, who commonly seek leverage by exploiting a variety of licence terms. Environmental groups not only enforce the terms of the social licence directly (for example, through shaming and adverse publicity), but also seek to influence the terms of the economic licence (for example, by generating consumer boycotts of environmentally damaging products) and of the regulatory licence (for example, through civil lawsuits or political pressure for regulatory initiatives). Thus the *interaction* between the different types of licence provisions extend the reach and impact of the social licence by directly empowering social activists or by giving them access to information that they can use to pressure target enterprises. Conversely,

a company that fails to respond appropriately to social licence obligations risks a tightening of its regulatory licence when frustrated community activists turn for help to politicians and regulators.

In terms of how firms *interpret* their CER, the in-depth study of 14 pulp manufacturing mills in the USA, Canada, Australia and New Zealand undertaken by Kagan, Gunningham and Thornton (2003) reveals that tightening regulatory and social licences has dramatically improved environmental performance in all the enterprises they studied, pushing most 'beyond compliance' in varying degrees. Yet firms' 'economic licences' have limited the extent of beyond-compliance measures and CER initiatives. The authors conclude that regulatory risk-intensifying regulatory standards are still very important in driving large and rapid improvements in environmental performance and that most companies either build in a margin of safety or go substantially beyond compliance in order to minimize the risk of an adverse regulatory reaction. Moreover, community and environmental activists can sometimes push companies to take further environmental action, even when it is not required by regulation, because of their capacity to threaten reputation.

But this research also found that terms of each strand of the 'licence to operate,' are often far from clear. Different corporate managers may interpret similar regulatory, economic or social demands differently and, consequently, their position as regards CER. For example, how far is it rational for an enterprise to go in reducing environmental risk, particularly when risk-reducing measures are costly and seemingly unprofitable? Kagan, Gunningham and Thornton find that this depends very much not only on how an enterprise *perceives* those risks, but also on its 'environmental management style'.

Those whom the authors term 'true believers' saw considerable win-win opportunities in environmental investment. As one of their respondents put it, "We feel if we are vigilant, push for continuous improvement we can stay competitive ... [We ask] how can we reduce chemical usage, minimize energy use, and improve things like housekeeping efficiencies?" (Kagan, Gunningham and Thornton, 2003, p. 91) And, for them, minimizing environmental risk meant building good community relations. As the environment manager reported, "it's very important how the community sees the plant; how they are thinking is our license to operate" (p. 119).

In contrast, those whom the authors termed 'reluctant compliers' saw little virtue in environmental spending or in building positive relationships with the local community. Any such spending was viewed as 'money down the rat hole' and best avoided unless the regulator was threatening strong and imminent enforcement action. Even firms confronting very similar external pressures interpreted those pressures very differently.

Overall, then, Gunningham, Kagan and Thornton show that CER involves multiple and interacting licence terms. Differences in social licence demands often appeared to be particularly powerful in influencing different environmental outcomes and this, coupled with the risk of regulatory enforcement most commonly drove environmental behaviour. But how a company responded to environmental risks and how it interpreted CER opportunities also depended on management's varying perceptions of the scope for win-win outcomes (or whether management interprets environmental issues as threats or as opportunities, as Sanjay Sharma shows in Chapter 29) and on their perception of the importance of mitigating risk to their reputation. The latter, in particular, suggests that, from a public policy perspective, empowering the social licence (for example by providing the community with access to

information or the right to bring legal action) may be a particularly powerful point of leverage. For large, highly visible corporations, 'reputation risk' is becoming increasingly difficult to ignore.

## **Conclusion**

To return to the questions with which this Introduction began, CER, at least in the minds of its proponents, is closely related to competitive advantage. According to first-generation writers, win-win opportunities will be widely accessible across a multitude of different spheres of business activity. It is simply a matter of looking for them. To return to the parable of the economist and his son, there are lots of pieces of paper on the floor and most of them are valuable. Business simply has to pick them up. This view, of course, has not gone unchallenged. A number of other first-generation writers have taken a diametrically opposed view, asserting that win-win opportunities were rare and that business is better off recognizing this and acting accordingly. There might be lots of pieces of paper on the floor, but most of them are valueless, and, for the most part, the search costs of identifying the few that might have value far exceeds the likely benefits.

But this literature is an evolving one (as indeed is the broader CSR literature), and as this Introduction has shown, second-generation analyses are considerably more nuanced than their predecessors. They have progressed substantially beyond anecdotes to case studies and, in some cases, to empirically-grounded, broader-based analyses. The debate has moved substantially beyond the polarized accounts of first-generation writers to a contemporary concern to identify the circumstances in which CER makes good business sense, and how and when it might be best used to gain strategic advantage. Writers such as Reinhardt have made a considerable contribution in seeking to refine the range of circumstances that might provide strategic advantage and those that will not. This, of course, has made the debate much more complex. There are still lots of pieces of paper on the floor, but some are valuable and some are not, and the trick is to develop a strategy for identifying which are which without having to sort through the whole pile. Similarly, in the case of CSR more broadly, Graeme Auld, Steven Bernstein and Benjamin Cashore (Chapter 30) demonstrate the importance of distinguishing efforts to promote learning and stakeholder engagement from those requiring direct on-the-ground behaviour changes.

But, notwithstanding the increasing sophistication of the debate, there is still much that is not known empirically and, while the empirical literature points to some interesting trends, it does not as yet provide any systematic answers as to how far beyond compliance firms are willing to go, or whether CER is capable of making an important across-the-board contribution or provides little more than a niche market. Certainly, increasing numbers of business enterprises are being influenced by the CER movement and have begun not only to see the potential to improve economic efficiency and business image, but also to gain a competitive advantage through environmental initiatives. But how far is this development likely to extend beyond industry leaders?

One way of addressing this question is to ask why there is so much variation between different companies operating in the same industry. It was suggested that the risks that CER initiatives may circumvent and the opportunities that CER provides can best be thought about in terms of a socially constructed 'licence to operate'. This licence includes economic and

social demands as well as the demands of government regulators: what were termed the economic, social and regulatory licences respectively. What a company decides to do in terms of CER, it was suggested, can be explained largely by how it interprets and responds to the various licence terms.

This analysis suggests that certain firms and certain sectors are much more likely to go beyond compliance and behave according to the precepts of CER than others. For example large, reputation-sensitive companies which are regularly scrutinized by environmental groups and local communities will be particularly driven to go beyond compliance by the conditions of their social licence. Other firms or industries which are not subjected to such external pressures are far less likely to do so. And yet the analysis does not end there because different firms, even within the same industry sector and subjected to the same licence pressures, respond to them differently. In short, what was termed 'management style' matters considerably, although this, too, is an area where much work remains to be done in unpacking the various dimensions of this concept.

This analysis has important normative implications. For understanding the connections between the different strands of the 'licence to operate' also enables policy-makers to understand more clearly how various licence terms might be invoked to shape CER. For example, procedural empowerment through law (the regulatory licence) was found to be a particularly potent means of expanding the terms of the social licence and thereby the scope of CER, as was the use of the regulatory licence to expand the social licence through requirements to disclose comparative information.

Moreover, as Petra Christmann and Glen Taylor (Chapter 31) argue, to the extent that CER has genuinely shifted corporate environmental behaviour, then it may be appropriate for public policy itself to shift from a corporate accountability model (as through environmental regulation) to a corporate responsibility model. The latter implies a lesser role for legal compliance and a much wider role for voluntarism and self-regulation, driven by the enlightened self-interest of business in regulating itself. It is beyond the scope of this book to explore this argument in detail. Suffice it to say that much depends on the industry sector in question and on its economic circumstances. But, in broad terms, achieving effective industry self-regulation is never easy, and there are a substantial number of internal and external hurdles which must be overcome before self-regulation becomes a credible policy option (Gunningham and Rees, 1997).

Finally, it will by now be clear that CER is not a purely voluntary matter. There is considerable evidence to suggest that corporations participate in CER initiatives for essentially pragmatic reasons, usually justifying that participation in terms of a 'business case', in which particular emphasis is placed on risk management and, to a lesser extent, on opportunities for competitive advantage. Thus 'voluntary' CER initiatives are likely to be a calculated response to external pressures rather than an expression of any internal moral or philanthropic commitment.

But, if this is the case, one might reasonably conclude that beyond-compliance behaviour engaged in purely because it is good business practice and which is devoid of any moral or ethical overtones hardly deserves to be called corporate environmental responsibility. Small wonder that ENGOs prefer the substantially extended meaning of CER described earlier. They have, however, been singularly unsuccessful in persuading business to engage with it, for reasons that have everything to do with business self-interest and little, if anything, to do with environmental ethics.

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