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1 Corporate Sustainability – What It Is and Why It Matters

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LEARNING OBJECTIVES

- Reflect on how the relationship between businesses, nature and society has been reshaped and how this has affected corporate sustainability.
- Define corporate sustainability, responsibility and ethics.
- Learn about ways to categorise corporate sustainability issues.
- Understand different motivations for firms to adopt corporate sustainability.
- Recognise key tensions that surround the debate of corporate sustainability.

1.1 Introduction

Imagine for a moment you are in the year 2050. As you look around you, you see that the world has changed dramatically. Although the entire world economy is two and half times bigger than in 2019 (from around 94 trillion USD in 2019 to 251 trillion), the gains of this economic growth are distributed very unevenly among and within countries. The rising inequality sparks social frictions and armed conflicts. Even though extreme poverty and hunger are mostly eradicated, accelerated urbanisation and economic growth have caused significant natural degradation, which in turn negatively affected the well-being of people around the globe. Global warming is severe and has produced many irreversible effects, such as increased pressure on the availability of arable land and freshwater. Biodiversity loss has hit many of the Earth's ecosystems and made the world's poor and marginalised more vulnerable (e.g., smallholders in developing countries).

The scenario that we just described is not unrealistic. It was identified by a group of well-known researchers as likely to happen if economic and political actors around the world continue with 'business-as-usual' (Randers et al., 2018). This scenario rests on the assumption that although countries and businesses officially commit to fulfilling the Sustainable Development Goals (SDGs), which define the

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UN's agenda for sustainable development until 2030, no extraordinary policy efforts or regulatory measures are applied. Many politicians and business leaders make a sincere effort to make the world a more sustainable place, but in doing so they apply well-established thinking that focuses primarily on economic growth as a means to finance sustainable development. But, as we all know, more of the same is usually not enough to make big and lasting changes.

This book takes you on a journey to study how corporations can move beyond business-as-usual when it comes to corporate sustainability. We do not claim to have all the answers. Rather, we aim to make you aware of what sustainability challenges firms (and the society they are embedded in) are facing, which ways to tackle these challenges exist to date and what remains to be done. The contributors to this book will not always have positive messages to share, as many environmental and social problems continue to grow in terms of scope and impact.

Section 1.2 of this chapter will discuss the changing context in which business, nature and society at large operate. It is important to understand this context, because it shapes the problems that corporate sustainability aims to address, and it influences how firms can cope with these problems. Section 1.3 will look at three interrelated, yet distinct, concepts: corporate sustainability, Corporate Social Responsibility (CSR) and business ethics. We define each of the concepts and discuss differences and similarities among them. Section 1.4 introduces frameworks that help companies structure the many sustainability issues that they are facing. Next, in section 1.5, we introduce you to four key motivations that may drive firms' engagement in corporate sustainability. Although these motivations are presented as separate, they overlap in practice. Finally, in section 1.6, we look at key tensions that surround the debate of corporate sustainability. Understanding these tensions will help you to better grasp the problems and opportunities that are associated with corporate sustainability.

1.2 A Changing Context for Business, Nature and Society

To understand why discussions around corporate sustainability have gained so much momentum, it is useful to look into the broader context in which business, nature and society are embedded these days. We believe there are four central developments that have reshaped the relationship between business actors, the natural environment and society in recent years.

1.2.1 Increasing Relevance of ESG Challenges

Through their operations and strategies, corporations impact many *environmental, social* and *governance* (ESG) challenges. Of course, the reverse is true as well: these

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challenges also impact how firms do business, as they shape relevant risks and opportunities. Although we cannot provide a full review of all possible ESG challenges here, we can zoom into some important facts within all three dimensions.

The 'E' dimension within ESG refers to a wide variety of environmental issues (e.g., greenhouse gas emissions, freshwater supply, pollution; see also Chapter 23). One relevant framework to organise some of these issues relates to research showing that those environmental processes that regulate the stability of the Earth system are increasingly crossing irreversible thresholds. In 2009, a group of international researchers defined nine so-called 'Planetary Boundaries' (Rockström et al., 2009). These boundaries define specific thresholds at global or regional levels. The boundaries characterise the conditions that are necessary for planet Earth to remain in a stable state. According to further research (Steffen et al., 2015b), four out of the nine boundaries have already been transgressed (see Figure 7.2; see also Chapters 7 and 23). These four boundaries that have already been crossed relate to climate, biodiversity, biogeochemical cycles (regarding phosphorous and nitrogen in fertilisers) and land-system change (regarding deforestation). In other words, planet Earth has entered a danger zone. We have left the 'safe operating space' that the planet originally provided us with, and crossing these boundaries is likely to trigger nonlinear, abrupt environmental changes. It is vital to recognise that these nine boundaries also define the safe space within which the global economy operates. Likewise, our societies depend on Earth system processes to work sustainably for habitats, communities and societies to thrive. If these processes come out of balance, businesses will operate under increasingly unstable conditions (e.g., exposing firms to higher levels of risk).

To return to ESG, the 'S' dimension within ESG refers to the human and labour rights agendas (see Chapters 21 and 22), with labour rights usually being framed as a subset of broader human rights. Protecting and respecting human and labour rights remains a challenge in many countries around the globe, and the COVID-19 pandemic has worsened some problems (e.g., due to austerity policies that weakened public infrastructure). Due to the comprehensive nature of human rights, it is difficult to find one common measure. Nonetheless, one good point of orientation is the so-called *Fragile States Index*, which contains as one of its dimensions the *Human Rights and Rule of Law Index*. The index looks at whether there is widespread abuse of different types of rights (e.g., civil and political rights) and ranges from 0 (high protection) to 10 (low protection). The 2021 edition shows that out of 173 assessed countries, 60 had a score of at least 7 (The Fund for Peace, 2021). In other words, governments often do not do their job to protect citizens' basic human rights, which shows the need for non-state actors (e.g., businesses, NGOs) to become more engaged in respecting and protecting such rights. However, we also know that business actors are often the source for human rights abuses – for instance, when operating global supply chains in which labour rights are violated.

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Finally, the 'G' dimension within ESG refers to issues that relate to the proper governance of corporations, such as the structure and composition of the Board of Directors, shareholder rights, transparency, corporate lobbying and anti-corruption measures. In particular, corporate lobbying and corruption very much shape the societies we are living in. One widely accepted measure of corruption around the world is the annual *Corruption Perception Index* (CPI) by Transparency International (see also Chapter 24). This index measures the perception of public sector corruption in 180 countries and ranges from 0 (highly corrupt) to 100 (very clean). The 2020 CPI shows how widespread corruption is around the world: two-thirds of all countries score below 50, indicating that public sector corruption (e.g., bribery of government officials) remains a significant problem throughout the world. Even countries in Western Europe and the European Union only achieve an average score of 66 out of 100 (Transparency International, 2021a). It is therefore safe to assume that most countries still fail to address corruption effectively. Hence, business actors are central in the fight against corruption, as they can take precautionary measures directly at the individual and organisational levels.

1.2.2 Rising Scale and Scope of Corporate Activities

In many cases, businesses contribute directly or indirectly to the outlined ESG challenges. Think, for instance, about climate change, deforestation, labour rights and corruption. At first, this seems like bad news, as it shows that businesses are key contributors to many of the problems faced by societies around the globe. However, we can also flip this argument around. If businesses contribute to the very existence of many of these challenges, they can also help to address them. In fact, corporations are considered critical actors when addressing ESG issues because of their size and reach. Multinational corporations (MNCs) often dominate industries because of their disproportionate size. Consider the following example. In the global fishery industry, only thirteen businesses control 11 to 16 per cent of the global marine catch (Österblom et al., 2015). These corporations have significant power, as they operate an extensive global network of subsidiaries. Prior research has referred to such corporations as keystone actors – that is, corporations that (1) dominate the volume of production within a sector, (2) connect different ecosystems across the globe through a network of subsidiaries and (3) have an impact on global governance processes (Hileman et al., 2020).

Many argue that with this increasing scale of corporate activities also come enlarged corporate responsibilities. Corporations are increasingly seen as potentially reliable partners that can mobilise resources, provide innovations and comply with emerging standards. But the hope that corporations can help to solve some of today's biggest problems also creates risks. For instance, it furthers our dependence on corporations as the dominant institution in modern life, and it also blurs the relationship between public and private authority. Globalisation together with an

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emerging privatisation of public goods/services has given rise to a situation where the state has withdrawn from many areas where it traditionally exercised a regulatory monopoly or even a controlling and directing hand. Nowadays, the scope of corporate operations has increased significantly. Corporations provide goods like water, transport, education and healthcare. Private firms even run prisons and provide security, and have become important actors in the conduct of war. In short, corporations are critical to an increasing number of aspects of society, many of which are fundamental to security and welfare. As a result, firms have turned not only into more powerful actors, but also political ones.

Despite the dominance of MNCs, we should not forget that there is a plurality of corporate actors. Corporations are not a homogenous category of organisations, especially not when thinking about sustainability and responsibility. In fact, most firms in the economy are not large MNCs, but rather small and medium-sized enterprises (SMEs). These SMEs are the backbone of any economy; they offer essential services and are often part of larger value chains. We have also witnessed the emergence of several alternative types of organisations that address ESG-related challenges. Social businesses, for instance, often have a specific social or environmental mission as their main purpose. Such social businesses are for-profit organisations; they depend on making a profit and thus are financially self-sustaining (see also Chapter 9).

1.2.3 Digitalisation and Datafication

The relationship between corporations and (global) society has also shifted because of the rise of the digital economy. We are increasingly living in a 'datafied' society and this has significant consequences for the responsibilities of corporations. To datafy something implies to put it into a quantified format so that it can be analysed through digital means (Mayer-Schönberger and Cukier, 2013). Google datafies an enormous number of books through its Google Books project, while Facebook datafies friendships through 'like' buttons, and LinkedIn datafies Human Resources through online CVs. This datafication impacts corporations' responsibilities in numerous ways, and it also leads to a concentration of power in the hands of just a few companies (Whelan, 2021).

On the one hand, the rise of the digital economy has increased public scrutiny and has made responsible as well as irresponsible corporate conduct more transparent. Datafication has increased the connectivity of people who share more content in faster ways (e.g., stories about corporate misconduct). Some apps even give consumers direct access to a product's sustainability assessment, while other apps measure air pollution and allow for tracking deforestation. On the other hand, datafication has created new powerful corporations with a new set of responsibilities. Tech giants like Apple, Google, Microsoft and Facebook belong to the most valuable corporations in the world (when comparing the market capitalisation of all

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publicly traded companies). These firms impact peoples' rights in new and often unforeseen ways. In early 2006, Google announced that it would censor the Chinese version of its search engine upon request by the Chinese government. Similarly, Yahoo was asked to disclose information on at least two email customers to the Chinese government. Both customers, who were known to be government critics, were later jailed for revealing state secrets.

Digitalisation and artificial intelligence (AI) also offer new ways to strengthen ESG-related assessments. Consider the following example. Investors, like the fund manager Arabesque, use AI to analyse ESG data to better understand firms' sustainability performance. Technologies like machine learning and AI can help to analyse not only vast amounts of data, but also data that is not pre-structured (e.g., that is not neatly available in an Excel spreadsheet). News data, for instance, is not structured in any way. Investors increasingly analyse such data to learn more about firms' sustainability performance, also because firms' own sustainability reports usually underreport on negative ESG incidents (Selim, 2021). However, there is also a flipside to the rise of the digital economy. Digital applications and processes require significant levels of electricity. The Internet alone uses about 10 per cent of world electricity, while Bitcoin mining uses 0.5 per cent of world electricity (which is more than the amount used by the entire country of Finland; Kim, 2021).

1.2.4 Globalisation and (the Lack of) Global Governance

Economic, political and cultural globalisation are no longer news. They have been around for decades. Yet, their effects on corporations' sustainability and responsibility are still very visible because the regulation of *global* business activity remains a challenge. There is an imbalance between the flexibility of MNCs to spread their value chain activities across different countries and the still limited capacity of nation states and international governmental organisations to adequately regulate corporate conduct across borders. Scherer and Palazzo (2008) call this the 'regulatory vacuum effect'. Such a vacuum exists because the sovereignty of political authorities is greatest within their national borders and more tenuous outside them, while businesses have become transnational actors. This makes it difficult for individual countries' governments to address social and environmental problems that reach beyond single state boundaries. The failure to address global warming is a case in point. MNCs also have the chance to arbitrate among alternative regulations, that is, they escape strict regulations by moving their operations or supply activities to countries with rather low standards (e.g., to lower their tax burden or cost of production). All of this has led to a globalisation of sustainability and responsibility and calls for alternative ways to regulate global business activity.

Existing international governmental organisations, which reach beyond individual nation states (e.g., the UN system or the World Bank), lack the formal powers or political support to develop and enforce any binding rules or even sanction

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corporate misconduct. The UN system was mostly designed for state actors and falls short of regulating its Member States, but also when it comes to regulating non-state actors. Even when international law and UN-based treaties/conventions have been designed as a legal framework to direct the behaviour of nation states, it is rarely possible to apply these legal frameworks *directly* to corporations, especially when it comes to regulating their impact on social and environmental issues. In principle, it is technically possible to craft legally binding international frameworks applying to corporations, but political interests and corporate lobbying have curtailed such efforts until now.

Some have argued that the missing direct applicability of international law to corporations can partly be compensated by stronger extraterritorial regulation. Extraterritorial jurisdiction refers to 'the ability of a state, via various legal, regulatory and judicial institutions, to exercise its authority over actors and activities outside its own territory' (Zerk, 2010: 13). Put differently, states can apply certain domestic legal instruments beyond their own territory and hence can regulate the activities of corporate actors 'abroad'. Although the application of extraterritorial law has given rise to tensions between nation states, which see their sovereignty endangered, the use of such legal instruments is commonplace in a few areas relevant to the sustainability debate. For instance, the US Foreign Corrupt Practices Act allows the US government to sue corporations (even non-US ones) for offering or accepting bribes in another country (see Chapter 24). Even though the extraterritorial nature of certain domestic laws has helped to better regulate anti-corruption, it has not much affected other areas of the ESG spectrum. In 2013, the US Supreme Court rolled back the impact of the Alien Tort Claims Act (ATCA), which allowed the prosecution of human rights violations by corporate actors in other countries. Many proceedings under ACTA were objected to be based on the argument that the cases raise 'political questions' and that judicial action by a US court in this area would interfere with 'foreign policy interests' (Zerk, 2010: 152). Overall, we can state that extraterritorial law has improved the regulation of global business activity in some selected areas, but it has not sufficiently closed the general regulatory vacuum that surrounds the conduct of MNCs.

1.3 Sustainability, Responsibility and Ethics: What Are They?

Often, there is confusion around the terminology used when talking about businesses' roles in and relationships to society. Part of this confusion comes from academic work using concepts/terms in different ways, as well as differences in the language used by practitioners and academics. Some of the confusion is also due to concepts overlapping with one another. While we cannot ultimately resolve these

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problems, we hope to provide some clear definitions of the main concepts used throughout this book. We want to highlight three key terms, which we believe are at the heart of debates around businesses changing role in global society: *corporate sustainability*, *corporate (social) responsibility* and *business ethics*.

1.3.1 Defining Corporate Sustainability and Corporate (Social) Responsibility

Discussions around corporate sustainability are usually based on and relate to the popular notion of sustainable development. The World Commission on Environment and Development defined such development in a much-cited report as being about meeting 'the needs of the present without compromising the ability of future generations to meet their own needs.' (World Commission on Environment and Development, 1987: 54) This definition is *not* centred on the role of organisations or even corporations. Rather, it understands sustainable development as being concerned with the development of entire societies.

The idea of being sustainable can, of course, also be applied to the corporate context. Corporations can, for better and for worse, impact how sustainable the development of a society is and can therefore align their activities more or less with wider sustainability imperatives. We therefore define corporate sustainability in the following way:

> Corporate sustainability focuses on managing and balancing an enterprise's embeddedness in interrelated ecological, social and economic systems so that positive impact is created in the form of long-term ecological balance, societal welfare and stakeholder value.

This definition offers some important implications.

1. Corporate sustainability views an enterprise's activities in the *context of larger systems*. In the 1990s, several researchers used the term corporate sustainability exclusively in an ecological sense. The focus was predominantly on discussing businesses' impact on the natural environment and opportunities resulting from innovation and eco-efficient production (Shrivastava, 1995). We use the term corporate sustainability to emphasise that economic, social and environmental issues are part of larger systems, and that these systems interact with one another. Corporations, for instance, impact and are impacted by various natural systems, like the Earth's climate system. These systems, in turn, influence the risks and opportunities that firms face (e.g., climate transition risks) and hence companies' long-term economic bottom line. Whether and how firms address these risks and opportunities affects living conditions within societies (e.g., not taking action on climate change will undermine the living conditions of many people around the world).

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2. Corporate sustainability aims at *balancing* social, environmental and economic interests while doing business. It therefore aims to avoid situations where taking action in support of one sphere comes at the expense of another sphere. Finally, the definition also highlights that corporate sustainability is concerned with outcome measures such as ecological balance, societal welfare and the creation of stakeholder value. Creating value therefore reaches beyond a rather narrow focus on a firm's monetary bottom line, but includes generating value for the company's stakeholders and the society it operates in, as well as the natural environment that surrounds its operations.

While the corporate sustainability debate emphasises the need for systems-level change, discussions around CSR are often more focused on relevant management practices within corporations. CSR does not neglect the connected nature of social, environmental and economic aspects, but its main focus is on how to manage these aspects in a corporate context and regarding the impact of corporations on the social, environmental and economic circumstances of their stakeholders. Corporate sustainability, on the other hand, puts more emphasis on how changes made by an individual corporation connect and contribute to larger systems-level change (Montiel, 2008). We therefore define CSR as follows:

> CSR refers to the integration of an enterprise's social, environmental, ethical and philanthropic responsibilities towards society into its operations, processes and core business strategy in cooperation with relevant stakeholders in a context-specific way.

This definition, which builds on the definitions by the European Commission (2001, 2011), stresses that CSR is not entirely about philanthropy (e.g., companies' charitable donations). While a firm's CSR strategy can include philanthropic activities, and may have been built on these, it is much more than that. Well-designed CSR goes into the very core of a corporation; it influences its everyday practices and business processes and is aligned with its overall business strategy. Corporate philanthropy is sometimes detached from a firm's core activities, while CSR is about reflecting on the social, environmental and ethical impact of these activities. This is not to say that CSR always must be 'strategic' (a term that is often used as a synonym for 'being profitable'; Porter and Kramer, 2006). Rather, it means that CSR should be embedded into a firm's purpose and what it does on a day-to-day basis, and it should also be reflected upon when deciding upon a firm's strategic direction (e.g., which markets or regions it wants to enter).

The CSR debate is often confronted with one essential question: What are firms responsible for? One good way to discuss possible answers to this question is to look at Carroll's (1979, 1991) pyramid of corporate responsibilities (Figure 1.1). At a fundamental level, firms have to make sure that they meet economic responsibilities (i.e., making a profit). Without being profitable in the long run, corporations will

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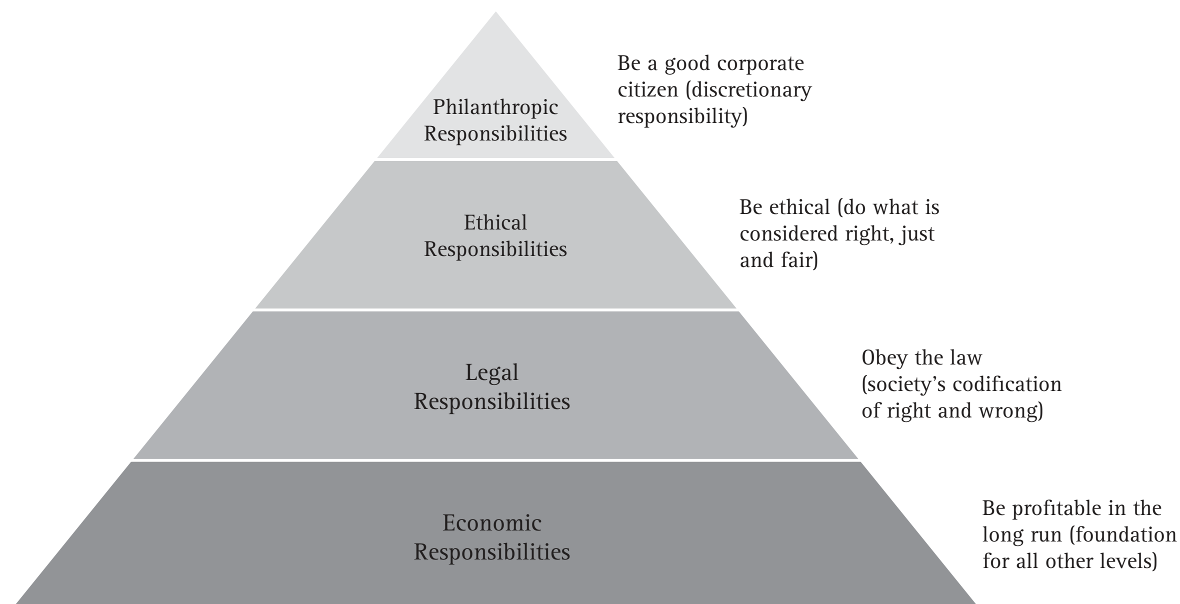

Figure 1.1 The pyramid of corporate responsibilities.
Adapted and modified from Carroll (1991).

cease to exist and hence cannot address other types of responsibilities. The next two levels of Carroll's pyramid consist of legal responsibilities (compliance with the rule of law) and ethical responsibilities (acknowledging what is regarded as right and just within a society). The final level consists of philanthropic responsibilities that are discretionary and therefore only desired, but not expected, by society.

Let's reflect for a moment on the definitions of corporate sustainability and CSR. At first, it is important to note what both definitions do *not* mention. Neither definition indicates that corporate sustainability or CSR are voluntary concepts. We believe it would be misleading to conceptualise both constructs in this way. Addressing social and environmental issues is a de facto requirement in some industries and countries. For instance, it is hard to find firms in the automotive or extractive industries without any relevant sustainability activities, because their sectors have developed industry-wide norms and standards. In many countries, companies observe 'implicit' obligations to undertake certain responsibilities simply by virtue of being members of those societies, as Matten and Moon (2008) revealed in their comparison of US and European CSR. Also, some governments have started to incentivise or even regulate social and environmental activities (e.g., the disclosure of relevant non-financial information; see Chapters 12 and 17). This has pushed the debate beyond talking about purely voluntary actions.

We explicitly use the term 'enterprise' in both definitions. With this we want to highlight that corporate sustainability and CSR are not only concepts that are

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