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The dark side of sustainability orientation for SME performance

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ABSTRACT

This article examines how a firm's willingness to make trade-offs that favour sustainability over commercial goals attenuates the relationship between firm-level sustainability orientation and subsequent performance. The hypothesis development draws on stakeholder theory and the literature on mission and revenue drifts, while the empirical analysis is based on two waves of original survey data on Finnish manufacturing SMEs. We find that sustainability orientation is positively associated with performance only when the willingness to make sustainability trade-offs is low, whereas the relationship becomes negative when the willingness to make such trade-offs is high. Our findings thus suggest that the popular adage of *doing well by doing good* might only hold if doing good does not conflict with business interests. The results add to stakeholder theory by showing how conforming to stakeholder expectations can be good for business – but only if doing so does not seriously compromise the pursuit of profits.

1. Introduction

Entrepreneurship research increasingly focuses on founders and firms being driven by alternative motivations to economic self-interest (e.g., Fauchart and Gruber, 2011; Gruber and MacMillan, 2017; Muñoz et al., 2018; Parrish, 2010). Prior research suggests that pursuing social objectives is not only good for the founder's wellbeing (Miller et al., 2012; Shepherd, 2015), but for-profit firms can *do well by doing good*; in that they can improve competitiveness and legitimacy by acting in a socially responsible manner (Bansal and Roth, 2000; Berrone et al., 2013; Demuijck and Fasterling, 2016).

At the same time, recent studies address the dark side of socially oriented venturing: Muñoz et al. (2018), for example, found that an excessive focus on social purpose to the detriment of the business model in the early stages of a new organisation can harm subsequent performance; Renko (2013) found that prosocially motivated entrepreneurs face greater difficulties in the start-up process than those that follow purely economic motives; and Young (2012) describes how too great an emphasis on social goals can weaken the firm and possibly lead to commercial failure.

In a recent paper, Lynn (2020) challenges the *good-ethics-pays* paradigm and recommends research moves beyond ungrounded confidence in a grand theory of win-win between social and business goals, and instead investigates the provisional and contextual social

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mechanisms that reward or sanction socially motivated action. The present article follows that last recommendation and adds to our understanding of the *conditions* under which sustainability orientation – referring to the management's attitude and conviction that the firm should act in ways beneficial for the environment and social welfare (Kuckertz and Wagner, 2010; Muñoz and Dimov, 2015) – can adversely affect firm performance.

We apply stakeholder theory (Freeman, 1984) to develop the basic hypothesis that sustainability orientation will be positively associated with business performance because sustainable business practices align with stakeholder preferences that increasingly favour sustainability (Landrum, 2018). Subsequently, we draw on the research on mission and revenue drifts (Battilana and Dorado, 2010; Ebrahim et al., 2014) to propose that this positive relationship is contingent on the firm's willingness to make trade-offs that favour sustainability over commercial goals. Specifically, we argue that sustainability orientation and performance are positively related only when the firm is not willing to compromise its commercial goals to adhere to sustainability principles. However, if the firm is determined to make such trade-offs, a sustainability orientation can jeopardise performance. We test and find support for our hypotheses with two waves of original survey data on 136 Finnish SMEs in the manufacturing sector.

The current study contributes to the emergent findings mapping the dark side of sustainability orientation by shedding light on the conditions under which the pursuit of sustainability objectives can jeopardise performance. Moreover, we add to stakeholder theory by analysing the conditions under which organisations should consider increasing or reducing their responsiveness to stakeholder preferences.

2. Theory and hypothesis development

Stakeholder theory posits that a firm's value-creation activities should consider the varied interests of all of its stakeholders, a cohort encompassing every group or individual with a legitimate interest in the firm (e.g., customers, suppliers, employees, investors, and local communities) (Freeman, 1984). A firm, therefore, builds legitimacy and enhances competitiveness by identifying and conforming to stakeholder expectations (Bansal and Bogner, 2002). Careful stakeholder management can positively impact key relationships (Jones, 1995), reduce transaction costs (Williamson, 2008), and improve the firm's resources (Hunt and Davis, 2008).

Several studies anchored in stakeholder theory have established a positive link between sustainable business practices and firm performance (Classen and Roloff, 2012; Ehrhart et al., 2011; Mueller et al., 2009). The theoretical logic is that a sustainably oriented firm aligns itself with the preferences of its stakeholders, which recent research shows increasingly and homogeneously favour sustainability (Fink, 2020; Landrum, 2018; Lee and Ha-Brookshire, 2017; Siegel, 2009). Such an alignment allows the firm to generate more value for its stakeholders than its less sustainably oriented competitors, which in turn reflects positively on business performance (Freeman and Liedtka, 1997). More generally, purpose-led companies outperform their competitors in terms of market share and growth rate, while also achieving higher levels of workforce and customer satisfaction (O'Brien et al., 2019).

While the evidence favouring sustainable business practices seems compelling, being primarily driven by stakeholder interests may lead firms to lose sight of their business objectives. While there are different philosophical schools of thought explaining why the *good-ethics-pays* logic might well be flawed (see Lynn, 2020), a key reason is that commercial firms can be poorly suited to pursuing wider social and environmental objectives. Wang and Bansal (2012), for example, recognised that in most established corporations socially responsible activities are costly and distract management from the pursuit of commercial goals. In that situation, profit generation and sustainability objectives would be at odds. A driving factor in that potentially antagonistic relationship is that pursuing a dual orientation is complex, and moreover, competing institutional logics can trigger intra-firm tension (DiVito and Bohnsack, 2017; Kok et al., 2019). Trade-offs between the dual objectives are therefore often necessary, and those trade-offs can undermine either the firm's sustainability goals or its profit objectives (Figge and Hahn, 2012; Moeller et al., 2011).

From the vantage point of the social enterprise, *mission drift* occurs when the organisation increasingly abandons its sustainability orientation to focus on its financial profits, thus abandoning its initial mission (Battilana and Dorado, 2010). Mission drift can have adverse effects on the firm's stakeholder relationships within (Doherty et al., 2014) and outside the organisation (Dart, 2004) that, in the worst-case scenario, can even jeopardise the firm's survival (Battilana and Lee, 2014). Studies also suggest that once mission drift has commenced, reintroducing the neglected pro-social values is troublesome (Battilana and Dorado, 2010; Battilana et al., 2012). The challenge for social enterprises, therefore, is to sustain a healthy balance between the pursuit of social objectives and commercial requirements (Smith et al., 2013). It is thus no surprise that the top-performing social enterprises have a stronger economic orientation, and they are both more economically and socially effective than low performers (Staessens et al., 2019).

We propose that the same dynamics are present from the vantage point of a for-profit enterprise, especially when the environmental views of its stakeholders are aligned. Under those conditions, being responsive to stakeholders makes business sense: sustainable business practices enhance an organisation's legitimacy in the eyes of its stakeholders, and such practices can boost competitiveness if customers are willing to pay a premium or switch from less sustainably operating suppliers to more sustainable ones (Bansal and Roth, 2000). However, the process cannot be taken too far or the firm risks *revenue drift* (Ebrahim et al., 2014), which occurs when an increasing focus on sustainability comes at the cost of the neglect of business obligations. Revenue drift can mean a firm undermines its fiduciary duty to its shareholders.

Our contention is that some mission drift and some revenue drift can be beneficial in a world with aligned stakeholder expectations: given a degree of mission drift, sustainably oriented enterprises do not lose sight of the commercial objectives that keep them alive, and similarly for-profit enterprises permitting some revenue drift can improve the legitimacy and competitiveness of the business by demonstrating a willingness to respond to stakeholder preferences.

The empirical element of this study focuses on sustainability orientation in for-profit firms. We investigate the performance risk faced by such firms if they do not allow their business practices to drift from their sustainability principles, even if some mission drift is

warranted to enhance performance. More specifically, we postulate that a high level of sustainability orientation can improve performance because it aligns the firm with its stakeholders' preferences for sustainability. However, we propose that the positive performance effect requires there be no trade-offs where the firm is willing to prioritise sustainability objectives over commercial goals. If the firm is willing to compromise profits to uphold its sustainability principles, a sustainability orientation can undermine commercial performance. We summarise the above arguments in the following hypotheses:

Hypothesis 1. A sustainability orientation will be positively associated with business performance when the firm's willingness to make trade-offs that favour sustainability over commercial goals is low.

Hypothesis 2. A sustainability orientation will be negatively associated with business performance when the firm's willingness to make trade-offs that favour sustainability over commercial goals is high.

3. Materials and methods

3.1. Data

We test our hypotheses on a combination of two waves of original survey data supplemented with financial data obtained from Bureau van Dijk's Orbis database. We used the Orbis database to identify firms in the manufacturing sector that meet the European Union criteria for an SME. We chose the manufacturing sector because sustainability concerns are particularly salient in sectors that turn raw materials into products. Not only do these sectors typically have a larger carbon footprint than other sectors, but they are also responsible for the depletion of exhaustible natural resources. While many manufacturing firms do not operate at the consumer interface, they nevertheless feel the pressure to implement sustainable procurement and production because their stakeholders downstream in the supply chain – industrial clients, end product manufacturers, retailers, and ultimately consumers (Priem, 2007) – prefer sustainably manufactured products and demand sustainable practices from firms throughout the supply chain.

In wave 1, a professional research agency contacted all 1620 firms identified in the database by telephone and introduced the study to a top management team member. Those managers who agreed to participate in the study immediately received a link to an online survey form. Of the 568 managers who agreed to participate in the study, 267 submitted a complete set of responses (response rate: 47%). For wave 2 conducted two years later, we contacted all firms that had participated in wave 1. In order to reduce common method bias, we asked to speak to different top management team members than those who had participated in wave 1. At least two different managers from 136 firms participated in wave 2 (response rate: 51%). The process made it possible to use one manager's responses for the sustainability trade-off scale and another's evaluation of the firm's performance to further reduce common method bias. Finally, we merged the survey data with financial statement data derived from Orbis.

We controlled for nonresponse bias by comparing the mean number of employees and the means of various financial indicators drawn from the Orbis database between those 267 firms that responded to wave 1 and the remaining 1353 that were eligible but did not participate (Rogelberg and Stanton, 2007). The differences in the means were marginal and the highest *t*-value for the test of equality of means was $t=1.27$ ($p=0.20$). Therefore, nonresponse does not appear to constitute a major bias. We used the same variables to analyse attrition bias by comparing the 136 firms that participated in both waves with those 131 that would have been eligible for wave 2 but that had opted out. We did not find statistically significant group differences (the highest *t*-value was $t=1.51$, $p=0.13$). Hence, non-random attrition bias does not seem to be an issue in our study.

3.2. Measures

The dependent variable, measured in wave 2 from the input of manager A, captures *firm performance* with a 4-item scale adapted from Covin et al. (1990). The items enquired of the respondent's satisfaction with the firm's performance with respect to sales level, sales growth rate, gross profit margin, and return on investment on a 5-point scale anchored with *very dissatisfied* (1) and *very satisfied* (5). The Cronbach's alpha coefficient for the scale is 0.84.

The independent variable, *sustainability orientation*, was measured in wave 1 from the input of manager B with a 6-item scale adapted from Muñoz and Dimov (2015). Sample item: 'I strongly believe in the power of our business to contribute to solving many of the problems we have as a society'. The items were measured on a 7-point scale anchored with *strongly disagree* (1) and *strongly agree* (7). The scale has a Cronbach's alpha of 0.74.

The moderating variable, *sustainability trade-offs*, was measured in wave 2 from the input of manager C with a 4-item scale adapted from DiVito and Bohnsack (2017). Sample item: 'Our management team would be willing to accept reduced profit if it could offer a more environmentally friendly product'. The items were measured on a 5-point scale anchored with *strongly disagree* (1) and *strongly agree* (5). The Cronbach's alpha for the scale is 0.86.

Finally, our regression analysis included a number of *control variables*: firm age in years, firm size in number of employees, and profit margin and return on equity as financial indicators that could influence the manager's subjective evaluation of performance. The values for each of these variables were extracted from the Orbis database. We also experimented with other financial indicators as controls but did not find they significantly influenced performance or altered the substantive results. Hence, for parsimony and in order to maximise the power of the regression model given our small sample, we opted for the aforementioned small selection of control variables.

3.3. Confirmatory factor analysis

Before computing index scores for the multi-item scales, we examined their discriminant validity using confirmatory factor analysis. We compared a model in which all items load on their intended factors to model specifications where the items belonging to any two scales load on a single factor. The former consistently resulted in a superior fit between the model and the data. The fit indices for the specification in which all items load on their intended factors suggest satisfactory fit: the comparative fit index score of 0.955 exceeds the recommended threshold of 0.95, and the root mean squared error of approximation and standardised root mean squared residual index scores of 0.052 and 0.058 fall below the recommended maxima of 0.06 and 0.08, respectively (Hu and Bentler, 1999). Moreover, the average variance extracted scores clearly exceed the squared correlations between the latent variables, which indicates discriminant validity is not a significant issue (Fornell and Larcker, 1981).

4. Results

Table 1 displays the descriptive statistics and correlations for all variables included in the analysis. **Table 2** reports the ordinary-least-squares estimates for two model specifications: Model 1 displays the unconditional effect of sustainability orientation on firm performance, whereas Model 2 adds the hypothesised interaction between sustainability orientation and sustainability trade-offs. We examined both model specifications for multicollinearity by computing the variance inflation factor scores. Those scores were very small – even in the interacted model the highest score was 1.17, clearly below the commonly applied threshold of 10 to indicate serious multicollinearity. We analysed outliers and influential observations by examining residuals, leverages, Cook's distance scores, and leverage-versus-squared-residual plots. Using combinations of these criteria, we identified a number of observations that could bias our results. We re-estimated the models in **Table 2** by excluding the potential outliers and found the results to be robust.

The coefficient of sustainability orientation in Model 1 is not significant at conventional threshold levels. This means either that sustainability orientation is not significantly associated with firm performance, or there is a significant relationship, but that it is contingent on another variable and that not including this contingency in the model masks the significant effect.

Model 2 accounts for the hypothesised contingency of the effect of sustainability orientation being conditional on the level of sustainability trade-offs. The significant interaction term supports the interpretation that the relationship between sustainability orientation and firm performance is contingent on sustainability trade-offs. In order to shed further light on this relationship, we followed Aiken and West (1991) and computed the marginal effect (simple slope) of sustainability orientation on firm performance when willingness to make sustainability trade-offs is set at one standard-deviation unit below and above its mean (**Fig. 1**).

Fig. 1 shows that the effect of sustainability orientation is positive ($\beta=0.19, p=0.080$) when the willingness to make trade-offs is low, whereas the effect becomes negative ($\beta=-0.20, p=0.047$) when the willingness to make trade-offs is high. We explored the regions of significance by computing the marginal effect of sustainability orientation on firm performance for the full range of values of the moderator at 0.1 intervals (Brambor et al., 2006). **Fig. 2** displays the marginal effects and their 95% confidence intervals. If the confidence interval is fully above or below the zero line, the effect is significant at the 5% level. The marginal effects indicate that sustainability orientation is positively and significantly associated with firm performance when willingness to make sustainability trade-offs is very low; one unit or more below the mean of the variable (14% of the sample firms fall into this range). From one unit below the mean to 0.7 units above the mean the effect is not significant (61% of the sample). For values exceeding 0.7 above the mean, the effect is negative and significant (25% of the sample).

These findings support our hypotheses: sustainability orientation is positively associated with firm performance when the firm is unwilling to sacrifice its profits to pursue its sustainability goals, whereas it is negatively associated with performance when the firm is prepared to make substantial trade-offs that favour sustainability over profits.

5. Discussion

Following stakeholder theory (Freeman, 1984), we argued that in principle, conforming to stakeholder expectations with sustainable business practices is good for the firm's performance. At the same time, based on the literature on mission and revenue drift (Battilana

Table 1

Means, standard deviations and correlations.

	Descriptives				Correlations					
	Mean	SD	Min	Max	1.	2.	3.	4.	5.	6.
1. Firm performance	3.26	0.78	1	5	1					
2. Sustainability orientation	4.59	0.95	1	7	-0.01	1				
3. Sustainability trade-offs	2.67	0.74	1	4.25	0.11	0.17*	1			
4. Firm age	37.04	33.45	2	111	0.03	-0.06	0.16	1		
5. Firm size (employees)	67.79	55.55	10	233	-0.08	0.08	-0.00	-0.15	1	
6. Profit margin	4.12	9.51	-52.00	25.82	0.21*	0.01	0.03	-0.05	-0.04	1
7. Return on equity	18.82	80.01	-305.13	619.92	0.10	0.07	-0.09	-0.09	-0.05	0.34*

Notes: $n=136$. Pearson correlation coefficients. Logarithmic transformation used in correlation analysis for firm age and firm size. * denotes statistical significance at the 5% level.

Table 2

Ordinary-least-squares regression estimates.

Dependent variable: firm performance	(1)			(2)		
	β	SE	p	β	SE	p
Sustainability orientation	-0.02	0.07	0.784	-0.01	0.07	0.951
Sustainability trade-offs	0.11	0.09	0.220	0.13	0.10	0.158
Sustainability orientation * sustainability trade-offs				-0.26*	0.10	0.011
Firm age (years, log)	0.01	0.08	0.905	-0.00	0.08	0.974
Firm size (employees, log)	-0.06	0.09	0.461	-0.05*	0.08	0.554
Profit margin	0.02*	0.01	0.045	0.02*	0.01	0.022
Return on equity	0.00	0.00	0.593	0.00	0.00	0.726
Intercept	3.41**	0.46	0.000	3.42**	0.45	0.000
R-squared	0.06			0.11		

Notes: n=136. * and ** denote statistical significance at the 5% and 1% levels (two-tailed). Sustainability orientation and sustainability trade-offs are mean-centred.

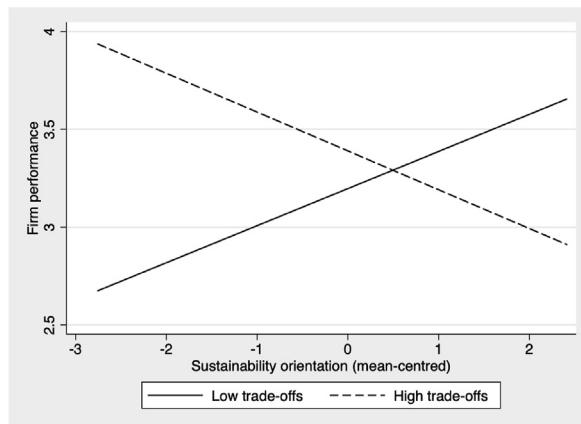


Fig. 1. Marginal effect of sustainability orientation on firm performance when the willingness to make sustainability trade-offs is set at one standard deviation unit below and above its mean.

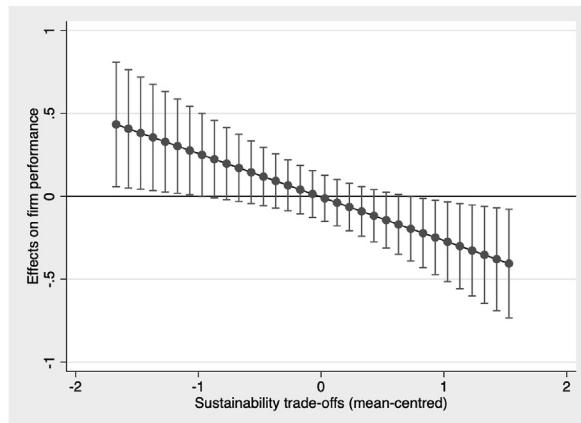


Fig. 2. Marginal effect of sustainability orientation on firm performance for the full range of values for sustainability trade-offs at 0.1 unit intervals (vertical lines depict 95% confidence intervals).

and Dorado, 2010; Ebrahim et al., 2014), we proposed an important condition for the positive effect: being sustainable is good but only if it does not involve substantial trade-offs that sacrifice profits for sustainability. Our empirical results supported this argumentation and are in line with prior research findings (Muñoz et al., 2018; Renko, 2013; Young, 2012) demonstrating that companies cannot always do well by doing good.

For stakeholder theory, the finding suggests that for commercial enterprises, adhering to stakeholder preferences for sustainability

can be good for business – unless the policy is taken too far. Consistently favouring sustainability over profit risks revenue drift (Ebrahim et al., 2014). That situation can arise if acting upon stakeholder preferences for sustainability becomes such an important part of the company's mission that the action clouds its commercial judgement and jeopardises business performance, which in turn can jeopardise the firm's long-term survival. Accordingly, responsiveness to stakeholders alone is no guarantee of performance. If an organisation sets a mission that consistently prioritises sustainability over commercial goals, it might best operate as a social enterprise or NGO that is funded by philanthropy or government support and thus does not need to generate commercial revenue to finance its operations (Coombes et al., 2011; DiVito and Bohnsack, 2017).

At the same time, our findings imply that ignoring stakeholder preferences for sustainability can be harmful: sustainability orientation and performance were positively related for firms that prioritised profits over sustainability when confronted with such trade-offs. Therefore, conforming to stakeholder expectations to some extent is good for performance, which in turn means that ignoring them completely and pursuing profits by whatever means necessary would risk alienating key stakeholders and compromising performance. Not even appearing to be sustainably oriented would then be akin to an extreme case of mission drift (Battilana and Dorado, 2010), where an initially socially focussed business abandons its social mission entirely and becomes solely profit-oriented.

In summary, our findings imply that businesses must be creative when trying to optimise financial and non-financial goals simultaneously (Mitchell and Walinga, 2017). This is particularly salient in the manufacturing sector where many firms operate in business-to-business markets and therefore do not benefit directly from a greater consumer willingness to pay. In the absence of a consumer price premium for sustainability, a manufacturing firm's sustainability orientation must focus on efficiencies and waste reduction that can cut costs or at least maintain cost parity while improving sustainability.

The principal limitation of our analysis is the small sample size, which restricts the statistical power of the model. However, even with that limited power, the study offers significant results, and the robustness of those results is enhanced by the use of three different informants for the key variables of interest. The main implication for future research is a call for studies that clarify the conditions under which firms can optimise responsiveness to stakeholder preferences for sustainability while avoiding revenue drift.

Declaration of competing interest

We confirm that we do not have any competing interests to declare.

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