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Does financial resource slack drive sustainability expenditure in developing economy small and medium-sized enterprises?

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ABSTRACT

While firms continue to commit slack financial resources to sustainability causes, knowledge is lacking on how financial resource slack drives sustainability expenditure under varying conditions of market pressure and political connectedness in a developing-economy market. Using primary data from exporting small and medium sized enterprises in Nigeria, this study shows that increases in financial resource slack are associated with decreases in sustainability expenditure. Additionally, results indicate that the negative effect of financial resource slack on sustainability expenditure becomes positive when levels of market pressure are higher. However, the negative effect relationship is strengthened (i.e. becomes more negative) when levels of political connectedness are greater. We discuss theoretical and managerial implications of these findings.

1. Introduction

Improvement in sustainability practices of corporate entities continues to dominate the academic literature and the global media. Policy makers, and local and international activist groups continue to put pressure on businesses to balance their economic performance with social and environmental practices (Leonidou, Christodoulides, & Thwaites, 2016; Varadarajan, 2014). This development has prompted many business organizations to focus on non-economic (i.e., sustainability) activities to boost their societal standing (Melnyk, Sroufe, & Calantone, 2003). To this end, organizations are increasingly using sustainability metrics as a tool to demonstrate moral behaviors that attract customers and investors (Brown, Dacin, Pratt, & Whetten, 2006).

Although many organizations continue to designate significant amounts of financial capital to support sustainability causes (Hockerts & Wüstenhagen, 2010), a major unresolved issue is whether organizational leaders are justified in increasing or decreasing available monetary resources to such causes (Cheng, Ioannou, & Serafeim, 2014; Cohen, Smith, & Mitchell, 2008). While arguments have been made from an agency cost perspective that greater expenditure on sustainability causes is wasteful and amounts to misapplication of constrained organizational resources (McWilliams, Siegel, & Wright, 2006), stewardship theory proponents argue that greater resource commitment to sustainability programs is a social good that should be encouraged (Davis, Schoorman, & Donaldson, 1997; Schaltegger & Wagner, 2011). While stewardship theory has traditionally been studied within the context of large multinational enterprises in developed markets, this stewardship argument is taking strong root in small business firms from developing-economy markets. For example, Osei-Duro design and clothing producer in Ghana and Mikuti fair-trade jewellery label producer in Tanzania, have established robust, ethical supply chains in their Sub-Saharan African markets by committing significant per cent of their total annual sales to sustainable sourcing of materials at home and abroad (Ras & Vermeulen, 2009).

Despite the burgeoning managerial and academic interest in sustainability issues, scholarly research is yet to examine when financial resource slack drives sustainability expenditure (Cohen et al., 2008; Hall, Daneke, & Lenox, 2010). Previous research has focused mainly on understanding drivers of sustainability expenditure among multinational enterprises located in developed-economy markets, ignoring potential variations in the sustainability expenditure outcome of financial resource slack in firms located in less developed markets. Accordingly, this study contributes to the sustainability literature by examining the institutional conditions under which financial resource slack influences sustainability expenditure in developing-economy firms.

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This study draws insight from institutional development logic (Cheng et al., 2014; Julian & Ofori-Dankwa, 2013) to posit that greater financial resource slack lowers sustainability expenditure in developing-economy firms due to inherent institutional weaknesses in enforcing compliance to sustainability causes. Our contention is that money is hard to come by in developing economies (and even harder for small and medium-sized businesses) due to weak capital market and harsh business environment conditions. As a result, firms tend to be understandably more prudent, focusing more on conserving capital than spending more on optional operations such as sustainability causes. However, because market conditions can potentially shape the outcome of firm behavior, we draw on stakeholder theory to argue that when market pressure on firms to act sustainably increases, developing-economy firms are more likely to spend greater amount of available capital on sustainability causes. Furthermore, we argue that because political engagement is a major aspect of doing business in developing-economy markets, and because laws and regulations are informally (and poorly) enforced in such markets (Peng & Luo, 2000), firms with slack capital are able to reduce their operational expenses by being closely aligned with key political leaders. Therefore, we further argue from a social exchange perspective that the effect of financial resource slack on sustainability expenditure is weakened when firms in developing-economy markets build greater political connections with state authorities (Zhao & Lu, 2016). In examining these contingencies, therefore, this study enriches scholarly knowledge by showing how unique conditions in developing-economy markets and idiosyncratic circumstances of small and medium-sized enterprises (SMEs) help broaden understanding of determinants of sustainability expenditure.

2. Literature review

2.1. Organizational resources and sustainability expenditure

Discretionary organizational resources provide firms with slack (Seifert, Morris, & Bartkus, 2004), constituting uncommitted resources beyond those needed to convert a given level of input into output (Nohria & Gulati, 1996). While an organization may possess multiple slack resources (e.g., extra raw materials, excess labour, additional work-in-process inventory, surplus production or machinery capacity), the most discretionary of all slack resources is excess or slack financial capital (Austin, Kresge, & Cohn, 1996). Financial resource slack is defined in this study as utilizable financial capital that can be diverted or deployed by an organization to achieve its goals (George, 2005). Financial capital is often captured by capital at hand (i.e., net profit after all discretionary expenses and taxes are deducted), and is considered a firm's major monetary resource (Austin et al., 1996). The literature on social engagement argues that profitability is the strongest indicator of “availability of resources to potentially fund social [and environment] investments” (Julian & Ofori-Dankwa, 2013, p. 1321). Drawing on the sustainability literature, sustainability expenditure is, therefore, defined as the amount of money (e.g., percentage of sales and/or profit) an organization commits to social and environmental causes.

While academic work has indeed been conducted on the relationship between financial resource slack and corporate expenditure on sustainability (i.e., corporate social and environmental responsibility) (e.g., Cheng et al., 2014; Gibbert, Hoegl, & Välikangas, 2007), the literature is fragmented and lacking in consensus on the direction of causality between resource slack and sustainability expenditure. In addition, empirical findings remain inconclusive about sustainability expenditure as an outcome of financial resource slack. Stakeholder and slack resource theories have been the dominant theoretical perspectives used to explain how slack impacts on sustainability.

2.2. Theoretical rationales for firm expenses on sustainability causes

Stakeholder theory holds that greater sustainability expenditure helps firms boost accumulation of financial resources (e.g., Cheng et al., 2014). Several perspectives are presented to support this position, one being that greater expenses on sustainability help lower negative regulatory, legislative, and fiscal actions against a firm, enable a firm to attract greater financial capital from the market. When socially and environmentally conscious market players believe a firm spends more on sustainability causes, investment tends to flow to the firm from non-traditional sources, such as non-governmental organizations and state-owned institutions (Kapstein, 2001). For example, McGuire, Sundgren, and Schneeweis (1988) find that greater expenses on social causes drive a firm's stock market performance. Additionally, research shows that greater sustainability expenses provide a firm with greater access to valuable resources (e.g., recruitment and retention of high-quality employees) and help lower a firm's advertising budget (Cheng et al., 2014). Stakeholder theory further supports the contention that, greater sustainability expenses help a firm creates social legitimacy, thus boosting a firm's reputation assets (Fombrun, Gardberg, & Barnett, 2000).

From a slack resource theory standpoint, firms with greater financial resource slack have an increased flexibility to invest in greater sustainability causes (Cheng et al., 2014; Orlitzky, Schmidt, & Rynes, 2003). Evidence shows that greater retained profit is positively related to social performance (Waddock & Graves, 1997). Additionally, Orlitzky et al.'s (2003) meta-analysis shows that average annual percentage returns to investors, market return on security, monthly stock returns, changes in stockholder dividends, and shares are all positively related to corporate social performance.

2.3. Understanding sustainability expenditure in a developing-economy setting

The pressure on developing economy businesses to publish their sustainability footprints is growing steadily given the increasing cases of social and environmental disasters, including the Bhopal gas explosion in India and environmental degradation in the Niger Delta. This growing importance of sustainability issues in corporate boardrooms in developing-economy markets has compelled many African countries to sign up to the requisite United Nations Global Impact requirement for holding businesses accountable for their commitments to social and environmental causes.

However, researchers have drawn on institutional development arguments to speculate that, while greater financial slack may cause developing-economy firms to commit greater financial capital to sustainability causes, this relationship may be weakened when sustainability regulations in these societies are less functional (Khavul & Bruton, 2013). Additionally, because sustainability issues receive low priority from key market actors (e.g., customers, suppliers, distributors, and competitors) and non-market actors (e.g., policy makers and the general public) (Julian & Ofori-Dankwa, 2013), and given low knowledge of developing-economy market consumers about the benefits of sustainability (Scott & Vigar-Ellis, 2014), the incentives for firms to commit greater financial capital to sustainability causes may be limited. Furthermore, it is contended that firms operating in institutionally less-developed markets face severe and unpredictable market conditions that can threaten their survival (Bruton, Filatotchev, Si, & Wright, 2013; Shevchenko, Lévesque, & Pagell, 2016), providing a disincentive for such firms to channel their slack financial capital to non-essential business practices. It is further argued that, when market-supporting institutions are poorly developed and when money is hard to come by, capital fund accumulation, conservative spending, and risk-aversion serve as safeguards against unexpected market upheavals (Quartey, 2003). In view of these unique features of less developed institutional environments, it is reasoned that greater access to slack financial resources is unlikely to result in greater expenditure on sustainability causes. A major gap exposed in the existing literature, therefore, is that limited studies have theoretically argued and empirically tested the relationship between financial resource slack and sustainability expenditure in developing-