Redefining Strategy in the Age of Sustainability and Social Responsibility

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Abstract

I examine how strategy is defined in the literature and find that most conceptualizations predominantly focus on financial metrics as measures of performance and mainly provide guidance on the strategic management of a corporation’s economic context. I also explore the work on externalities and corporate social responsibility to understand how environmental and social issues have been integrated in the literature. I find that environmental and social performance is examined either in isolation or by assuming a strong form of independence from financial performance. Therefore, I identify a clear gap in our understanding of the fundamental strategic problem in the age of sustainability and social responsibility. I highlight the urgent need for rigorous research around the phenomenon itself, and its theoretical implications for strategy as a field. Importantly, I suggest and discuss an extended definition (i.e., a reconceptualization) of strategy, and I refer to empirical evidence of the emergence of the “sustainable organization”—a distinct type of the modern corporation that effectively and profitably integrates environmental and social issues into its strategy. I also briefly suggest avenues for future research.
Introduction

Over the past few decades, several countries around the world have experienced unprecedented economic growth as measured by unceasingly accelerating GDP growth rates. This explosive growth, however, has also led to overconsumption or even destruction of natural resources, and to an overwhelming and unsustainable increase in greenhouse gas emissions. The ensuing impacts on global warming and climate change have severely damaged the planet’s capacity to sustain human development. According to current estimates by the World Wildlife Fund ([WWF] 2012), by 2050, when the earth’s population is expected to reach 9 billion, we will need as many as three planets to sustain current levels of consumption.

Beyond the negative environmental consequences, this type of economic growth has generated several pressing social issues: ever-increasing income inequality; often uncontrollable urbanization; high unemployment rates, particularly within the younger segments of the population; and social immobility leading to social instability, and even social unrest, around the world (e.g., the Occupy movement). This is especially evident when one considers the proliferation of NGOs and their increasing demands and expectations of companies, governments, and transnational institutions. Or when one considers that, according to Oxfam (2014), currently the world’s 85 richest individuals own as much wealth as does the bottom half of the entire global population. In other words, we are witnessing a potential erosion of the social fabric across countries, despite our collective ability to produce more goods and services than ever before.

Meanwhile, in the business world, multiple corporate scandals, coupled with the recent dire crisis of the financial system itself, the numerous environmental disasters directly attributed to companies’ operations (e.g., the BP oil spill), and even the resulting and regrettable loss of human life due to compromised health and safety standards (e.g., the Savar
building collapse in Bangladesh, suicides at Foxconn), have severely undermined the public’s trust in the modern business organization, and demands for transparency and accountability, as well as fierce debates on the broader role of the corporation within civil society, have begun to emerge.

These formidable environmental and social forces, in conjunction with the inherent pathologies of the capitalist system itself (e.g., short-termism), have threatened—or, in some instances, completely eradicated—the corporations’ traditional “license to operate”. Executives therefore now struggle to identify and prioritize their non-shareholding stakeholders and to understand the boundaries of their corporations’ responsibility. Thus, they face significant challenges when mapping a strategic course for their organizations within a fundamentally unfamiliar and fast-evolving environmental and social context. And they need to do so while also managing the more traditional and perhaps relatively better-understood economic context and meeting demands for financial profitability. Yet such demands, at least in the short term, may well directly conflict with actions they need to take to meet the expectations of their non-shareholding stakeholders—such as employees, local communities, or the environment.

These are both pressing and daily preoccupations for CEOs globally. The 2013 UN Global Compact–Accenture CEO study (Accenture, 2014) found that 97% of the 1,000 CEOs interviewed across 103 countries and 27 industries see sustainability as important to the future success of their business, and that 78% see sustainability as an opportunity for growth and innovation. Notably, 84% of the CEOs believe that business should lead efforts to define and deliver sustainable development goals, and 79% of them see sustainability as a route to competitive advantage in their industry.

From a strategy point of view, therefore, accounting for or even integrating environmental and social issues into a company’s business model, processes, and operations
introduces critical new elements in the continuing quest to understand what drives persistent performance heterogeneity across firms over time—the question at the heart of strategy research. In this article, I suggest that the boundary of what constitutes corporate performance is being extended beyond the traditional financial (profitability) metrics to include environmental, social, ethical, and corporate governance metrics (i.e., what are termed ESG dimensions). Moreover, I suggest that the long-term persistence of superior performance no longer depends exclusively on the management of the economic context. Instead, it requires an integrated approach in terms of concurrently managing the social and the environmental context, thus delivering value both to shareholders and to non-shareholding stakeholders in a synergistic manner.

Specifically, I first examine how strategy is defined and conceptualized through the eyes of the main schools of thought and the leading strategy scholars. I find that such definitions and resulting conceptualizations predominantly focus on financial metrics as measures of performance, and they provide guidance mainly on how to manage a corporation’s economic context. Next, I consider the literature on externalities and corporate social responsibility (CSR) to understand how environmental and social issues have been integrated. I find that despite the important insights that have been generated through these literatures, they still suffer from what Edward Freeman and others term “the separation fallacy”: the notion that it is wrong to believe that any business decision has no ethical content or any implicit ethical point of view, or that any ethical decision has no content or any implicit view about value creation and business. In other words, these literatures explore social and environmental performance either in isolation or by assuming a strong form of independence from financial performance and traditional notions of strategy formulation, thus failing to provide a holistic and integrated understanding of strategy.
In sum, in this article I characterize a clear gap in our understanding of the fundamental strategic problem in the age of sustainability and social responsibility. I highlight the rather urgent need for rigorous research around the phenomenon itself, as well as its theoretical implications for strategy as an academic field of inquiry. After reflecting upon the state of the field today, I offer an extended definition (i.e., a reconceptualization) of strategy, and I reference empirical evidence for the emergence of the “sustainable organization”—a distinct type of the modern corporation that effectively and profitably integrates environmental and social issues into its strategy. Finally, I briefly suggest fruitful avenues for future research.

Do We Even Need a Definition for Strategy?

Numerous articles have attempted to characterize strategy either by exploring research traditions or schools of thought in strategic management (e.g., Nag, Hambrick, & Chen, 2007; Nerur, Rasheed, & Natarajan, 2008; Ramos-Rodríguez & Ruiz-Navarro, 2004; Ronda-Pupo & Guerras-Martin, 2012) or by focusing on the role of the strategy function within and across organizations (Van den Steen, 2013). In what follows, I predominantly explore a strategy construct that encompasses strategy’s broader meaning and purpose, including its operational and practical aspects, but that also incorporates the major theoretical lenses that have emerged in academia.

Most of the major strategy textbooks offer an explicit or assume an implicit definition of what strategy means for business (e.g., Grant, 2010; Lynch, 2012). Indeed, strategy scholars have historically left their mark on the field by offering their own distinct conceptualization of strategy. For example, in his seminal 1962 book *Strategy and Structure*, Alfred Chandler (1962) defines strategy as “the determination of the long-run goals and objectives of an enterprise, and the adoption of courses of action and the allocation of
resources necessary for carrying out these goals” (p. 16), while Michael Porter, in his influential 1996 article “What Is Strategy?” in the *Harvard Business Review*, emphasizes that strategy is not just about operational effectiveness (i.e., doing things better than others) but rather is about doing things differently, and hence the essence of strategy is about understanding underlying trade-offs and making choices.¹

Interestingly, some academics have pointed out that these numerous and readily available strategy definitions often appear to contradict one another, or to significantly overlap exactly because they might be deliberately vague or simply too broad to be useful (Hofer & Schendel, 1978). Nevertheless, I would argue that as academics, we collectively do have a sense of what strategy is, although we are frank in acknowledging that some ambiguities or even disagreements still exist. This does not imply that pursuing a definition and a sufficiently exact conceptualization of strategy is not a worthwhile objective. Quite the contrary: a more precise definition is useful not only for monitoring and evaluating the progress and (scientific) maturity of the field (Kuhn, 1962; Popper, 1963) but also for delineating the locus of responsibility, and indeed for rethinking and reconceptualizing the role of the corporation within society. This is also imperative especially if one notes the work of the late Sumantra Ghoshal, highlighted in his highly influential 2005 article “Bad Management Theories Are Destroying Good Management Practices”: “Many of the worst excesses of recent management practices have their roots in a set of ideas that have emerged from business school academics over the last 30 years” (p. 75). In other words, delineating the ideological boundaries of what constitutes strategy in a world in which companies face growing demands for environmental and social responsibility, ethical stewardship, unprecedented levels of transparency, and even for leadership in addressing the world’s most pressing global issues, becomes critical in terms not only of focusing managerial attention and action but also of guiding research towards uncovering the dynamic mechanisms through
which such issues may be genuinely and profitably integrated into a company’s business model, operations, processes, and procedures.

**What Is Strategy, Really?**

To date, scholars have explored the concept of strategy and its boundaries through various approaches. In their highly influential book, Rumelt, Schendel, and Teece (1992) proposed a few key and distinct questions that either are or should be addressed by the strategy field, and which, according to the authors, *de facto* delineate the boundaries of the field’s inquiry. More recently, Nag et al. (2007) used text analysis to arrive at a single unifying definition of strategy by extracting key terms and concepts they found across the set of definitions put forth in the management literature. Specifically, they inferred that “the field of strategic management deals with the major intended and emergent initiatives taken by general managers on behalf of owners, involving utilization of resources, to enhance the performance of firms in their external environments” (p. 944).²

Relatedly, Ronda-Pupo and Guerras-Martin (2012) engaged in a citation and co-citation analysis of all available articles within the broader realm of the strategy literature to identify the most influential and “core” works. Based on this analysis, the authors derived a definition that effectively embeds them: “The essence of the strategy concept is the dynamics of the firm’s relation with its environment for which the necessary actions are taken to achieve its goals and/or to increase performance by means of the rational use of resources” (p. 180).

Nag et al. (2007) outlined seven key concepts that are largely reflected by Ronda-Pupo and Guerras-Martin (2012) as well: “environment”, “firms”, “performance”, “strategic initiatives”, “internal organization”, “resources”, and “managers and owners”. Of these, the concepts appearing most frequently in the scholarly definitions were “firms”, “environment”,

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² The cited reference is not shown here, but it is assumed to be included in the full document.
Arguably, these key elements also reflect conceptualizations of the underlying causal mechanisms that are being tested within the strategy field. Specifically, “firms” as well as “owners and managers” are typically used as the primary unit of analysis, whereas “internal organization”, “environment”, “resources”, “strategic initiatives”, and “managers’ and owners’ actions” generally constitute the independent variables. “Performance”, the concept appearing most frequently, is the key dependent variable across studies.

It is worth noting that the disciplinary background of the scholars who suggested the definitions included in the analysis was found to be an important factor. For example, economics-, marketing-, and sociology-oriented scholars did not consider “resources” to be an important component of strategy, whereas management-oriented scholars did. Moreover, “strategic initiatives” were particularly important for sociology- and marketing-oriented scholars, but less so for economics- and management-oriented scholars. As perhaps expected, the concepts of “internal organization” and “managers and owners” were most important for marketing-, management-, and sociology-oriented scholars, but not for economics-oriented scholars. The “environment”, “firms”, and “performance” were very important across all disciplinary orientations.

Overall, as much as these derived definitions are comprehensive, in that they are based on a large and diverse body of scholarly work, it is also useful to contextualize them by noting that, typically, the term “environment” refers to operationalizations of the surrounding economic context, whereas the term “performance”, in the majority of cases, refers to a measure of financial performance. As I will argue later on, it is rather challenging, even at the level of definitions, to embed environmental, social, and ethical issues in these same constructs—both as inputs, in terms of strategy formulation and implementation, and as
outcomes in terms of metrics against which companies are held accountable—in a way that fruitfully guides future theory and practice.

Another approach to defining strategy is to identify which scholarly works and which authors are perceived as central to the development and evolution of the field. For example, papers in this category include Ramos-Rodríguez and Ruíz-Navarro (2004) and Nerur et al. (2008), who found that strategy was most influenced by Michael Porter (positioning school), Jay Barney (resource-based view [RBV]), Richard Rumelt (foundations book, diversification), Alfred Chandler (strategy and structure), Raymond Miles and Charles Snow (typology of competitive strategies), Oliver Williamson (transaction costs economics), Michael Jensen and William Meckling (agency theory), and Richard Nelson and Sidney Winter (evolutionary economics), among others. Correspondingly, the key sub-fields of strategy identified are organization theory, the RBV of the firm, the behavioral theory of the firm, agency theory, institutional economics, and corporate strategy.

Relatedly, both Ramos-Rodríguez and Ruíz-Navarro (2004) as well as Nerur et al. (2008) found that over the course of 21 years (1980-2000), there was a strong initial and ongoing influence of organization theory and a mounting influence of theories from economics (particularly industrial organization), as well as a rapidly rising influence of the RBV of the firm. Corporate strategy appears to have emerged in the 1990s, and, since 2000, evolutionary theory has arguably exerted a more pronounced influence in the strategy field.

Collectively, what these findings illustrate is a strong historical legacy of strategy as a field that can be traced back to industrial economics. Then, not surprisingly, a company’s external environment is composed primarily of competitors (including the threat of entry) and collaborators (e.g., suppliers, customers), and expected corporate performance is almost exclusively financial. At the same time, organization theory does integrate into strategy theories from sociology to help explain non-rational individual and group behavior within
firms, yet this integration does not lead to a holistic understanding of the company’s context. That is, strategy has yet to incorporate environmental, social, and ethical issues in a theoretically grounded way.

Other scholars regard strategy as a field that deals with the direction of an organization and as jointly describing those issues of primary concern to senior management or to anyone seeking to comprehend the reasons for success and failure across organizations. Specifically, in their influential volume *Fundamental Issues in Strategy: A Research Agenda*, Rumelt et al. (1992) conceptualized the process of strategy development and implementation as one that includes the selection of organizational goals, choices of products and/or services, the design and configuration of corporate policies (i.e., how will we compete?), the choice of corporate scope and diversity, and the design of an organizational structure and administrative systems in order to coordinate work.

The authors’ main argument is that this set of choices must be cohesive and integrated and that it also has critical implications for the probability of eventual success or failure of the corporation. They highlighted that strategy is a “practical” field in that it aims (or should aim) to solve real-world problems. Rumelt et al. (1992) indicated that the four core areas of interest for strategy scholars are (a) the understanding of individual firm behavior, (b) the exploration of why and in what ways firms differ, (c) the understanding of the role of leadership (i.e., headquarters in an international context), and (d) the understanding of how firms can perform better in the context of international competition. Arguably, the key topic that has strongly been associated with the evolution of the strategy field is the understanding of the sources of inter-organizational differences in performance and their implications for managers.

Similar to the studies that focused on derived definitions of strategy, the answers that Rumelt et al. (1992) provided to these questions—and the avenues for future research that
they suggested—appear to neglect dimensions of performance beyond the financial and remain relatively silent about managing contexts beyond the economic or engaging stakeholders beyond a corporation’s owners/shareholders. Clearly, the wording of these questions and definitions per se does not a priori preclude paying attention to and integrating environmental, social, and ethical issues into strategy. For example, the response to the question of why firms differ does not necessarily lead to an analysis of competitors and collaborators only; it may also lead to the consideration of communities, local government, and the environment.

Nevertheless, framing is important (Benford & Snow, 2000; Goffman, 1974). That environmental, social, and ethical issues were not explicitly integrated into these rather broad conceptualizations, in conjunction with strategy’s historical legacy, meant that for several years the field remained silent about guiding managerial practice on these topics, as well as about directing scholarly attention towards questions of corporate sustainability. It took several years for researchers at the periphery of the strategy field to begin to explore what came to be known as CSR issues.

In sum, the work that explores strategy from a definitional point of view seems to suggest that as long as the unit of analysis is the firm and the dependent variable of interest is some measure of the firm’s financial performance, then strategy as a field aspires to broadly understand how the interaction between decisions made by managers and owners and the environment in which the firm operates affects performance over time. Such decisions may involve the creation, acquisition, deployment, and divestment of resources; the positioning of the firm in its industry; the structuring of organizational processes; and, potentially, the establishing of the firm’s role within the universe of who the firm sees as its stakeholders.
A Brief Examination of Strategy’s Main Schools of Thought

A. Economics—the “Original” Definition of Firm Performance

As far as economics is concerned, companies maximize profits subject to capacity or some other forms of constraint (or equivalently: they minimize costs subject to these constraints) (Mas-Colell, Whinston, & Green, 1995). Therefore, companies are held accountable for how efficiently they generate maximum profitability. Respectively, firms that for various reasons do not perform at their potential maximum efficiency are typically selected out of the marketplace because, it is assumed, there is always a set of competing firms that can fully maximize profits and therefore replace the non-maximizing ones.

Performance in the context of economics is predominantly measured in terms of financial profitability, whereas variation in performance across firms is essentially driven only by constraints imposed by internal and external actors, other than the firm itself. Internal constraints typically refer to the minimum (or efficient) wages payable for the required quality and amount of labor and capital (e.g., Syverson, 2011). Consumers and competitors are typically the actors that impose external constraints on the firm, whereas some models also explore the role of suppliers and the government in generating them (e.g., Fama, 1980).

Consequently, in a state of “equilibrium” all surviving firms are typically performing at their best possible level given their constraints. Any two firms subject to the same constraints are assumed to perform equally well. Thus, the definition of performance in economics, as well as in the modeling tradition, does not easily permit consideration of other performance outcomes beyond profitability measures. Moreover, the management of the broader environmental, social, and ethical context has not yet been effectively integrated beyond the idea of “externalities” which I explore later in this article.

The management perspective is radically different from the economic perspective. First, firms always differ, even in the most narrowly defined set of circumstances, and they
differ because of their own choices. These choices are not based on a fully rational (or even supranational) model of behavior but rather are made by boundedly rational actors (i.e., firms have slightly different information sets and use distinct heuristics to screen and interpret that information). Second, these differences do matter, even in the aggregate, and cannot be assumed away in an idealized state of “equilibrium” whereby selection forces iron out heterogeneity in choices and firm behavior. Therefore, in more general terms, the goal of strategy may be summarized as the search for rents exceeding the opportunity cost of owners (Mahoney & Pandian, 1992). Unlike economists, though, strategy scholars argue that such rents are possible even in the long run, because some markets (e.g., strategic factor markets) are rarely, if ever, efficient.

B. The Positioning School

According to the positioning school, pioneered by Michael Porter in his seminal book *Competitive Strategy* (1980), firm performance is primarily driven by the firm’s choice of and position within an industry. Industries themselves differ systematically in the cross-section, in terms of their mean profitability and its variance. These differences arise because of five structural “forces” that are relatively stable over time and across industries: customers, suppliers, substitutes, potential entrants, and rivalry. In other words, the positioning school models a bargaining game played by the firm and these five categories of actors, and the end outcome (i.e., the distribution of industry profits) is essentially driven by each actor’s bargaining power.

Therefore, a firm can determine how to position itself within each industry by choosing whether to have a wide or narrow scope, and whether to compete on price or quality. Performance is measured as the financial profitability of each firm relative to its industry’s average. Each industry has a different average due to differences in the underlying
bargaining power of each actor (i.e., the industry’s structural elements), yet within an industry, some firms’ profits exceed the average exactly because of their choice of position.

This school of thought emphasizes the responsibility and power of management to decide what the firm does and how, within its industrial context. It also emphasizes the need for coherence in strategic choices: all decision elements need to “fit” together; otherwise firms can, for instance, be “stuck in the middle” (i.e., trying to implement both cost and quality leadership simultaneously) and therefore end up performing at the industry average or below (Porter, 1980, 1985; White, 1986).

In sum, although the positioning school did expand the set of stakeholders that are relevant for firm strategy by suggesting a broader notion of competition beyond direct rivalry to include pressures from customers, suppliers, substitute products, and even potential entry, the framework remains rather narrow in terms of capturing environmental, social, and ethical pressures. On the one hand, such issues do obtain at a level above the industry; on the other, they also have differential (even structural) implications across industries that are not and cannot be accounted for. Reflecting its intellectual origins in industrial economics, this framework also does not include dimensions of performance beyond the financial.

C. The Resource-Based View

The RBV conceptualizes performance as the ability to obtain and sustain a competitive advantage—defined, in turn, as above-average performance (e.g., Barney, 1991, 2001; Barney, Wright, & Ketchen, 2001; Penrose, 1959; Wernerfelt, 1984, 1995). Unlike the positioning school, though, RBV argues that the relevant key level of analysis is the firm, not the industry (e.g., Barney, 1991, 2001). Accordingly, a firm succeeds by achieving superior performance in ways that competing firms cannot imitate or by exceeding shareholders’ expectations. This conceptualization of performance is broader than profitability notions in
that it allows for other measures to be considered as outcomes. For example, Henderson and Cockburn (1994) explored research productivity as a critical firm-level outcome, although they assumed that superior research productivity will also lead to greater financial performance. Moreover, Mowery, Oxley, and Silverman (1996) studied partner selection in inter-firm collaborations using the RBV, and found that technological overlap helps predict the formation of alliances.

The core tenet of RBV is that by building valuable, rare, inimitable, and non-transferable resources and capabilities, a firm may be able to outdo its competitors and perform better than the average firm in the market. It also assumes that such resources and capabilities cannot typically be acquired in “strategic factor markets” because of major market failures (e.g., positive transaction costs, poorly defined property rights, and imperfect/asymmetric information) that are essentially the sources of resource heterogeneity (e.g., Amit & Schoemaker, 1993; Barney, 1986; Barney, 1991).

Therefore, the argument continues, no amount of positioning in the absence of such resources and capabilities will allow the firm to obtain superior levels of performance. Although the development of such resources and capabilities is time-consuming, costly, and time-dependent, this is exactly why they are hard to imitate; thus, other competing firms cannot quickly catch up (Dierickx & Cool, 1989). This process also implies that decisions made today have strong repercussions for future decision-making, and that managers need to be acutely cognizant of the long-term effects of their choices and the sustainability of their chosen strategies.

Empirically, research articles within the RBV tradition explore the extent to which above-average performance—either financial or in terms of productivity along a particular dimension—may be directly attributed to the firm’s possession of valuable, rare, inimitable, and non-substitutable resources and capabilities (e.g., Deephouse, 2000; Miller & Shamsie,
A closely related strand of literature also looks at how above-average industry performance is sustained in the context of rapidly changing environments and at how much of this performance can be attributed to “dynamic capabilities”—the ability to continuously reconfigure resources and capabilities to fit with the new environment (e.g., Helfat et al., 2007; Helfat & Peteraf, 2003; Teece, 2009; Teece, Pisano, & Shuen, 1997). To the extent that a firm’s underlying resources and capabilities may characterize its ability to generate rents through the integration of environmental and social issues, the RBV does allow enough scope for the explicit consideration and exploration of such issues. Indeed, a recent strand of the RBV has begun to explore the idea of environmental (natural) resources as valuable, rare, inimitable, and non-transferable resources that may constitute the basis for a competitive advantage (e.g., Hart, 1995; Hart & Dowell, 2011; Russo & Fouts, 1997). Nevertheless, as Hart and Dowell (2011) noted in their literature review, most of this work “has been focused on pollution prevention, with much less attention to empirical research on product stewardship or sustainable development strategies” (p. 1466).

Thus, the full integration and further development of theory in order to integrate natural resources into the RBV is still significantly lacking. A coherent understanding of the management of the broader environmental context has not yet emerged, and, even if it did, social performance as a synergistic outcome of financial (or innovation) performance has not even begun to be considered.

D. The Evolutionary School

Evolutionary economics maintains that firms are only loosely constrained in the sense that selection processes do operate, but they are not nearly as efficient as traditional economics assumes, and that, moreover, these processes do not operate by selecting only on efficiency
(Hodgson & Knudsen, 2004; Knudsen, 2002; Nelson & Winter, 1982, 2002). Consequently, even at equilibrium, some efficient firms may be selected out, and less efficient ones may remain. Recent empirical work has begun documenting performance distributions of this form (e.g., Bloom, Eifert, Mahajan, McKenzie, & Roberts, 2013; Bloom & Reenen, 2010). This is not to imply, of course, that profitability is irrelevant for a firm’s survival. To the extent that profitability also generates slack resources for the firm, it remains critical since it enables the firm to appease multiple parties, search more for alternative opportunities, and commit more mistakes that will not immediately bankrupt it (Iyer & Miller, 2008; Nohria & Gulati, 1996; Tan & Peng, 2003).

First articulated and pioneered by Nelson and Winter (1982), the evolutionary school argues that even firms facing the same conditions will inevitably end up formulating and implementing distinct strategies with different performance implications because of bounded rationality, search, latent internal conflict, and strong path-dependency (pp. 65-71, 139-162). It is important to note, strategy in the eyes of the evolutionary school is not really about the efficient resolution of the profit-maximization problem. Instead, they argue, real firm strategies are bounded by some existing commitments that are based on faith rather than calculation; they are very broad and do not specify particular actions; and they are typically not optimal for profit maximization even though, on average, surviving firms tend to be more rather than less profitable (Güth & Peleg, 2001; Schaffer, 1989).

In this line of inquiry, performance is usually defined in terms of financial profitability, yet there is less of an explicit and direct emphasis on the pursuit of a competitive advantage per se. Firms are assumed not to be able to search and understand the entire universe of choices at any given point in time in order to choose the optimal path to a competitive advantage. Instead, firms achieve the best possible (local) outcome by making
choices that are subject to the constraints of bounded rationality, and path-dependency (Katila & Ahuja, 2002; Stuart & Podolny, 1996).

I note also that, more broadly, evolutionary theory does not really focus on the issue of performance but rather emphasizes the need to understand the dynamic processes within a firm that have traditionally been omitted by economic theory. Thus, evolutionary economics explores the questions of how and why firm heterogeneity arises but remains agnostic as to what the best possible performance could or should be. Accordingly, when it comes to the understanding of environmental, social, and ethical issues, the evolutionary school does play an important role in terms of shedding light on the dynamic processes through which organizations may adapt to the new realities given their prior idiosyncratic histories, and in terms of assessing their overall ability to do so.

E. Population Ecology

Population ecology has been quite influential in the field of strategy, particularly in defining corporate performance. In fact, compared with the other major schools of thought, population ecology is the first to emphasize the survivorship bias in strategy theorizing (e.g., Hannan, Carroll, Dobrev, & Han, 1998; Hannan & Freeman, 1977). Most other theories study the strategies that enable the surviving firms to perform better, but as Carroll (1993) argued, they pay relatively much less attention to widespread bankruptcies, exits, and inefficiencies that are present in nearly all industries. In fact, some of the exiting firms attempt the same strategies as the surviving ones, but still fail because these strategies may increase risks or require capabilities that only more established firms possess (Thornhill, White, & Raynor, 2008).

Critically, population ecology explores legitimacy and survival as ends in and of themselves. Therefore, the theory not only allows for but also directly explores non-financial
aspects of corporate performance. Moreover, it maintains that the assumption that all firms seek competitive advantage is rather misguided (Gimeno, Folta, Cooper, & Woo, 1997). Even if a firm’s owners seek maximum financial returns given the constraints of the industry, employees, for example, who do not share in the profits of the firm, may well care more about its continued existence than its relative financial performance vis-à-vis its competitors (Cyert & March, 1963). Consequently, since organizations are usually composed of often-conflicting groups of actors whose conflicts need to be resolved, the exclusive pursuit of competitive advantage alone may not be feasible (March, 1962). Relatedly, population ecology argues that in some industries, remaining legitimate in the eyes of external stakeholders and consumers (i.e., maintaining the “license to operate”) may be more important than seeking to establish above-average profitability, simply because the selection processes in these industries may not act upon the efficiency dimension (Zuckerman, 1999).

By accounting for legitimacy as a corporate outcome, the theoretical lens of population ecology could be useful for thinking about corporate engagement in social and environmental issues. For example, to the extent that socially responsible and sustainable business practices result in superior access to otherwise scarce resources (e.g., through generating trust within the local community, or through attaining legitimacy in the eyes of consumers, suppliers, or governments), then population ecology would predict that firms that integrate social and environmental issues into their strategy will have better chances of surviving and potentially achieving superior long-term performance.

F. Resource Dependence Theory

Originally suggested by Pfeffer and Salancik (1978), the resource dependence theory (RDT) stresses the reliance of organizations on their external environment in order to survive and/or to outperform. This view is in contrast to previous theories that, according to RDT scholars,
focused excessively on internal factors and neglected critical external ones. Thus, Pfeffer and Salancik (1978) defined the notion of effectiveness as “an external standard of how well an organization is meeting the demands of the various groups and organizations that are concerned with its activities” (p. 11). Furthermore, they posited that just as the environment creates opportunities for and imposes constraints on the firm, the firm itself can and does manipulate its environment to create acceptance of itself. Nevertheless, the theory continues, this form of interaction does not arise on its own but is rather a consequence of the inherent interdependence between organizations and their environments.

This type of interdependence highlights the importance of relative power across actors given that, according to Thomson (1962), “an organization is dependent on some element of its task environment 1) in proportion to the organization’s need for resources or performances which that element can provide, and 2) in inverse proportion to the ability of other elements to provide the same resources or performance” (p. 31). Despite this interdependence, organizations cannot address each and every need and constraint in the environment, but can still survive due to “loose coupling”, a construct suggested to characterize the notion that the effects of any given action are only imperfectly felt by those affected and do not fully determine outcomes (e.g., March & Olsen, 1975; Pfeffer & Salancik, 1978; Weick, 1976).

The combined consequences, then, of interdependence and loose coupling suggest, on the one hand, that firms may be affecting more agents than they are even aware of, and, on the other, that agents may impose both binding and non-binding constraints on organizational performance. Accordingly, the logical extension of the RDT in the realm of socially and environmentally responsible business initiatives would predict that such initiatives will tend to be targeted towards those stakeholders that can best influence the organization. In addition, it would predict that under some conditions, firms might continue to survive or even perform
well without necessarily addressing the demands and expectations of the relatively less powerful stakeholders whom they may be affecting via their operations.

Nevertheless, applying the analysis of power proposed by Emerson (1962) would imply that firms need to consider the important fact that no power structure is eternal and that, instead, power imbalances lead to instability, which spurs changes aimed at reducing such imbalances. Therefore, in the long run, organizations that have chosen to ignore the needs of the more powerless groups can end up being punished when those groups regain power.

**G. Stakeholder Theory**

Established by Ed Freeman, stakeholder theory identifies as a “stakeholder” any actor who is affected by or who can affect the firm and/or its performance (Freeman, 1999; Freeman, Harrison, Wicks, Parmar, & de Colle, 2010; Freeman & Reed, 1983; Harrison & Freeman, 1999). Consequently, the relevant unit of analysis is “the relationship”: that is, the tie between the firm and any given one of its stakeholders. However, the definition of stakeholder is quite broad, and one of the main criticisms of the theory is that it does not provide sufficient guidance for prioritizing or distinguishing between relatively more and relatively less material stakeholders. Nevertheless, Harrison and Caron (1994) suggested that one possible path towards integrating stakeholder theory with strategy is to organize stakeholders into three categories: (a) the broad environment (e.g., technological change, societal forces, global political/legal forces), (b) the operating environment (e.g., suppliers, customers, competitors, financial intermediaries), and (c) the organization’s internal stakeholders (e.g., owners / board of directors, managers, employees). According to these scholars, priority should then be given to external stakeholders based on their ability to affect environmental uncertainty for the firm.
In this sense, stakeholder theory is useful because it enables companies to identify their key stakeholders and helps them meet their demands and expectations. To the extent that the broader civil society and the environment are identified as central stakeholders, stakeholder theory is perhaps the most promising avenue for integrating such issues in a refined conceptualization of strategy as a field. Empirical evidence to date already indicates that good stakeholder relations enable a firm with superior financial performance to sustain its competitive advantage longer, and that, good stakeholder relations also help poorly performing firms recover from disadvantageous positions more quickly (e.g., Choi & Wang, 2009).

Within this stream of work, Venkataraman (1997) argued that stakeholder conflicts are ubiquitous and form the basis of any existing organization. Therefore, he suggested, resolving these conflicts leads to the creation of new goods and services. For instance, examined through a stakeholder theory perspective, the typical trade-off between producing a cheap “brown” product and an expensive “green” product is a conflict between cost and the environment, which can be resolved through a product innovation resulting in a new product that is both cheap and environmentally friendly. Consequently, meaningful and potentially profitable integration of broader environmental, social, or even ethical issues into strategy may well take place through innovation in products, services, or a company’s business model itself. In this sense, future research may explore the ways in which innovation over the social and environmental universe of opportunities is similar to or different from our current understanding of more conventional forms of innovation (i.e., predominantly technological).

Despite its great potential to contribute to our understanding of environmental, social, and ethical issues as they relate to the modern corporation, at present the stakeholder theory literature does not seem to have arrived at concrete and actionable implications for companies. For example, how can companies identify the relevant stakeholders? How should
they trade off their often-conflicting interests? Moreover, if the answers to these questions are linked to specific ethical or moral principles, how could firms meaningfully approach them?

Finally, to the extent that stakeholder theory is associated with the stream of work that has empirically explored corporate social performance (CSP)—which I discuss later in this article—it has paradoxically suffered from Edward Freeman’s separation fallacy (Freeman, 1994; Harris & Freeman, 2008; McCloskey, 1998; Sen, 1987): the strand of literature on CSP typically conceptualizes social and financial performance as independent and distinct constructs (e.g., exploring whether CSP is an antecedent to financial performance and vice versa), thus failing to address the broader sustainability issues in an integrated and holistic manner. For example, it does not address questions about the organizational elements and dynamic mechanisms through which corporations may reconceptualize social and environmental issues as potentially profitable business opportunities and therefore fully integrate them into their strategy. I return to these issues when I later discuss the emergence of the sustainable organization.

**Bringing Social, Environmental, and Ethical Issues within Strategy**

Sufficient flexibility exists across most of the strategy schools to potentially integrate the exploration of social, environmental, and ethical issues, although relatively limited work has taken place to date to achieve this integration. Instead, the literature has witnessed the emergence of two arguably independent streams of work: (a) the first originates from economics and refers to these issues as “externalities”, and (b) the second is a stream within management that explores CSR and CSP. Although some noteworthy attempts have been made to theoretically anchor this work to existing schools of thought, and although many important insights have emerged, the two literatures have yet to bring social, environmental, and ethical issues to center stage and incorporate them into mainstream strategy. In what
follows, I briefly explore each of these streams of work, highlighting their insights but also indicating drawbacks, and thus emphasizing the need to return to our original thinking of what strategy is and how a reconceptualization of strategy may be particularly useful in terms of guiding future research work.

**The Textbook World of “Externalities”**

The literature on externalities has a rather long history within economics. The original formalization is attributed to Arthur Pigou and his seminal work on the *Economics of Welfare* (1920), but numerous other scholars have since further developed the concept. For instance, Becker (2007) noted that “externalities result from imperfect ownership of property, not from defects in the motivations induced by private ownership” (p. 84). Accordingly, imperfect ownership rights also lead to costly monitoring, making it difficult to discover who is doing what, and how. Furthermore, Varian and Repcheck (2010) provided an indirect definition of externalities by suggesting that they arise “whenever the actions of one agent directly affect the environment of another agent” (p. 432).

More generally, the definitions found in the literature to date appear to agree that externalities constitute either costs or benefits incurred by a third party when two other parties engage in a transaction (or, when a single party consumes a good or service). Typically, the transacting (or consuming) party does not take into account such costs or benefits and, therefore, the third party is not compensated for the costs she incurs or charged for the benefits she enjoys. In both cases, the theory predicts, market failure occurs in that harm is overproduced or benefits are underproduced. This is because the marginal social costs and benefits (i.e., the sum of private and public costs and benefits)—that are greater than the marginal private costs and benefits in the presence of externalities—are not taken into account by the transacting parties.⁶
Perhaps the most fundamental insight from this literature is that externalities lead to the failure of the first welfare theorem, which states that any equilibrium allocation in prices with transfers will be a Pareto optimal allocation (Arrow, 1951; Debreu, 1951). Pareto optimality suggests that no agent can be made better off without another agent being harmed in the process (Pareto, 1894, 1906). Therefore, externalities create a situation of suboptimality in the sense that it is possible to make some agents better off without harming others, even at equilibrium. This is because the positive or negative impacts of goods and services that may generate (destruct) utility for economic agents are not priced in, and as a result these goods and services are under- or overproduced. Consequently, the elimination of the externality can increase aggregate (social) welfare.

Given these critical implications for social welfare, it is not surprising that externalities have become a crucial area of research in economics. Many scholars over the years have suggested a variety of solutions to address the issue of externalities and market failure (e.g., Demsetz, 1967; Hardin, 1968; Ostrom, 1990; Pigou, 1920; Schmalensee, Joskow, Ellerman, Montero, & Bailey, 1998). First and foremost, economists proposed the introduction of “Pigovian” taxes: the idea that a price correction may result through taxing a company’s production of the good or service that creates the externality, so that production is adjusted back to optimality (i.e., when production is equal to what it would have been if the private agents took public welfare into account directly). Pigovian taxes therefore necessitate that the taxing authority knows exactly what the externality cost function looks like. In practice, however, not only are information and knowledge imperfect, but also obtaining them is not free. To this end, some scholars have even argued, albeit from very different perspectives, that there is no reason to suppose that government intervention will be more efficient than market solutions (e.g., Dahlman, 1979; Ostrom, 1990; Turvey, 1963).
Second, scholars have suggested that externalities may be appropriately priced in through the creation of new markets: markets in which parties can trade upon the externality (Arrow, 1969; Meade, 1952). For example, companies may be able to buy and sell pollution rights (e.g., cap-and-trade carbon markets). However, some of these markets tend to be very thin, and therefore not competitive, leading to further price distortions (Benz & Klar, 2008; Ibikunle, Gregoriou, & Pandit, 2011). Moreover, even though in some cases it may be feasible to measure the externality (e.g., carbon emissions), in other cases it may not be (e.g., impact on income inequality, social issues); therefore, it is highly doubtful that markets can function based on such limited and potentially unreliable information.

Third, the literature has suggested that well-defined property rights should be assigned to the externality and that bargaining be allowed to take place. This is the idea of the well-known Coase theorem that states, “provided that transaction costs involved in settling the issue are sufficiently low and property rights are clearly assigned, regardless of who bears the costs and benefits, the parties will be able to come to a mutually beneficial agreement themselves. Moreover, they have accurate and detailed information, so their decisions will be more efficient” (Coase, 1960). An important assumption here is that parties are willing to negotiate because there is surplus to be gained (and distributed) on all sides. One of the necessary assumptions for the theory is that the two negotiating parties will choose a mutually beneficial agreement (Hoffman & Spitzer, 1982). In real situations, however, parties may not be able to negotiate because, for instance, transaction costs are non-negligible; property rights are not or cannot be clearly assigned, when many parties are involved; or when there is joint ownership, the theorem no longer holds (Coase, 1960; Hoffman & Spitzer, 1982).

In sum, all of the proposed solutions to what economists would term the problem of externalities seem to have severe limitations, especially when it comes to their
implementation in the real world. First, to a considerable extent, social and environmental issues constitute for economists the epitome of externality. The standard undergraduate textbook example of an externality is pollution; a by-product of the firm’s production processes whose cost is not priced in because, for instance, there are no clearly assigned property rights to clean air or clean water (Besanko & Braeutigam, 2005, p. 697). Yet, there are at least two important drawbacks in framing social and environmental issues in this manner. For one, the language used to characterize them—as externalities—and which therefore artificially places them outside the realm of responsibility of the corporation, is at least problematic; at worst, it may have detrimental consequences for the underlying issues that the framework itself identifies as suboptimal from a social-welfare point of view. This type of language creates an artificial and arguably dangerous divide between what is internal and what is external to the corporation, with implications for the boundaries of corporate responsibility. Given the demands for transparency, accountability, and stewardship placed upon business today, one would be hard-pressed to find a real company that heavily pollutes, for example, but that would still consider pollution to be an “external” issue, simply expecting the government to deal with it through taxes or regulation.

Second, exactly because in this literature the burden of responsibility for externalities typically rests with the government, through the taxing authority or the assignment of property rights, it may also push companies more towards legal compliance than towards leadership on or innovation around these issues. For example, from both a firm’s and a social-welfare point of view, there is a stark difference between meeting minimum environmental regulations and fully adopting and implementing strategically a business model based on circular economy principles (i.e., going beyond “doing no harm” and actually having a positive impact on the environment).
The second limitation of economic solutions for externalities is that these suggestions appear not to have paid adequate attention to the role that the modern business corporation itself can play in resolving these issues. For some scholars, market failures are exactly why strategy, as a field of practice and field of inquiry, exists. The creation of the modern business corporation itself may be attributed to the very existence of market failures (Vickers, 1985; Williamson, 1971). Correspondingly, there is no valid reason why a priori one would assume that firms cannot conceptualize “externalities” created by other firms as potentially profitable business opportunities (equivalently, social “needs”) and through product, process, or business model innovations devise solutions that not only are profitable but also, help eliminate the externality itself. Eliminating externalities through the unleashing of the problem-solving capabilities of business, therefore, may concurrently and synergistically generate not only financial benefits for the innovating firm, but indeed, environmental and social value for civil society, in a way that may well be scalable and, thus, impactful.

The “Separated” World of Corporate Social Responsibility

Many articles within the broader field of management and economics to date explore the issue of the modern corporation’s social responsibility, from a theoretical as well as an empirical point of view. Attempting to understand the insights of all these articles in a meta-analytic way, Garriga and Melé (2004) suggested classifying the existing theories into four groups based on how they define the firm and its ultimate role in society. The first group supports that the sole purpose of the firm is wealth creation and that it is therefore responsible only to its shareholders (e.g., Friedman, 1970; Jensen, 2002; McWilliams & Siegel, 2001; Ogden & Watson, 1999; Porter & Kramer, 2002). Thus, to the extent that CSR directly leads to the generation of profits and profits alone, it could be accommodated as one more way, one more strategy or initiative, by which the firm generates wealth for its shareholders. The
second group, according to Garriga and Melé (2004), argues that firms exist because they can wield greater power over societies than individuals can, yet with greater power comes the responsibility to manage it and compensate for any wrongdoing those over whom the corporation has power. In other words, the purpose of the firm is (financial) wealth creation and the concurrent power management of any potential consequences within civil society (Davis, 1960, 1968, 1973; Donaldson, 1982; Donaldson & Dunfee, 1994).

The third group of articles typically acknowledges that firms depend on their environment for their continued survival and that they exist in order to connect stakeholders and managers with the goal of integrating their corresponding needs and demands with maximum effectiveness and efficiency. Thus, firms are responsible to all stakeholders (e.g., Ackerman, 1973; Bendheim, Waddock, & Graves, 1998; Carroll, 1979; Preston & Post, 1975; Wartick & Mahon, 1994). Finally, the fourth group more specifically acknowledges that firms are embedded in a civil society that has certain ethical values which the firms themselves must also honor and represent. Accordingly, firms have a moral responsibility to their stakeholders in that they should not only compensate them financially for any wrongdoing but also maximize stakeholder benefits, whenever possible, since the forgoing of opportunities to generate positive externalities may be perceived as immoral by society (e.g., Bowie, 1991, 1998; Donaldson & Preston, 1995; Freeman, 1994; Mahon & McGowan, 1991; Velasquez, 1992).

Within the strategy literature specifically, the vast majority of research has focused on seeking evidence of the financial benefits that may be generated through socially and environmentally responsible initiatives. Margolis et al. (2007) offered an excellent and comprehensive review of this literature that, in the aggregate, finds a small positive but statistically significant impact of CSR on financial profitability. The rather implicit assumption in many of these studies is that firms should pursue such activities only insofar as
they lead to greater financial returns for the corporation (Devinney, 2009; Siegel, 2009).

More recently, though, the literature has begun to move towards understanding the conditions under which CSR may lead to financial profitability rather than focusing on whether, on average, CSR links to profitability. For example, studies have explored whether CSR has a positive reputational impact or whether employees may become more loyal or more productive at firms that engage in CSR activities (e.g., Cheng, Ioannou, & Serafeim, 2014; Greening & Turban, 2000; Kim, Lee, Lee, & Kim, 2010; Turban & Greening, 1997).

Nevertheless, one critical difference between scholars who argue for and those who argue against CSR as a way of achieving competitive advantage is that the former group focuses on the long-term benefits of CSR, arguing that long-term returns are more important than short-term returns. The latter group, on the other hand, emphasizes the short-term costs and highlights the uncertainty of long-term returns to CSR. Importantly, though, the dominant view appears to be that CSR is just another strategic initiative aimed at generating profits within the economic context. This view therefore, ignores an explicit and direct strategic management of the social and environmental context (i.e. the inputs to the strategy process), and also does not consider social and environmental performance (i.e. the outputs of the strategy process) as dimensions of corporate accountability that are on an equal footing with financial profitability.

To a considerable extent, this conceptualization of CSR within strategy reflects what Ed Freeman characterizes as the separation fallacy (Freeman, 1994; Freeman et al., 2010; Harris & Freeman, 2008; Sen, 1987): the assumption that business decisions are independent of a broader ethical context—a context that clearly encompasses a responsibility to the environment and civil society—and that, therefore, corporate financial performance should be treated as separate and independent from corporate environmental, social, and ethical performance. It is no surprise, then, that rather than focusing on developing an integrated
theory of how environmental, social, and ethical issues are at the core of the fundamental strategic problem, the literature to date has focused on empirically finding a cause-effect linear relationship between them. In other words, it has been unable to grasp the synergistic, concurrent, and highly complex nature of the task of genuinely integrating environmental, social, and ethical issues into strategy.

I should also note that within the strategy domain, a rather limited body of work explores the multi-level drivers (i.e., antecedents) of corporate environmental, social, and ethical performance, in contrast to a myriad of articles on the drivers of financial performance. Studies reviewed in Margolis et al. (2007) only consider financial performance as a driver of social performance. With few exceptions (e.g., Campbell, 2007; Ioannou & Serafeim, 2012; Jackson & Apostolakou, 2010), other important determinants—such as factors at the level of institutions, at the level of the industry and regulation, or even at the level of the individual (e.g., incentives)—have by and large been ignored by the literature. Thus, there is a clear gap in our understanding of the drivers of firms’ environmentally, socially, and ethically responsible behavior.

In sum, to the extent that we are committed to a strategy field that is relevant to practice, but also theoretically rigorous, we should admit that we collectively face the dire need to a reconceptualize strategy in a way that draws attention to these issues, as well as to their corresponding outcomes—a way that is integrated (rather than artificially independent of) with the economic context and financial outcomes.

**The Emergence of the Sustainable Organization, and the Need to Redefine Strategy**

The societal concern about issues of sustainability and social responsibility has evolved from almost nothing in the early 1990s to a dominant theme today. It is therefore no surprise that issues of environmental, social, and ethical responsibility have been added to the daily
agenda of executives globally, much more so than ever before. However, as this article has argued, our current conceptualization of strategy—whether we adopt a definitional approach or whether we examine the major schools of thought—remains too narrow to characterize and understand the evolution of the modern corporation and its role within civil society, while such tectonic shifts are taking place. Historically, as a field, strategy has been focused on understanding persistent performance heterogeneity across firms over time, whereby performance has been confined to financial outcomes, and where persistence has been explored in terms of managing predominantly within the economic context. Of course, important insights have been revealed through many studies in the CSR and externalities literatures, with the critical caveat that such issues have been explored in relative isolation from the fundamental strategic problem.

Yet the shifts in the global landscape in terms of environmental and social pressures have significant implications for the conceptualization of the fundamental strategic problem. First, corporations are no longer accountable for their financial performance alone; they are also accountable for their environmental, social, and broader governance performance. This is exactly why the world is witnessing the proliferation of information intermediaries that provide extensive data, and rate and rank corporations, on their ESG performance (e.g., KLD, Thomson Reuters ASSET4, FTSE4Good Index, Dow Jones Sustainability Index). Reflecting such pressures, major corporations around the world are already issuing sustainability or even integrated reports, in addition to the mandatory annual financial reports. There is also increasing evidence that capital markets use this type of information, alongside traditional financial metrics, to make their investment decisions (Eccles, Serafeim, & Krzus, 2011). In other words, corporate accountability and transparency in terms of performance has moved well beyond the financial metrics to include, on an equal footing, non-financial metrics. Second, it is evident that companies cannot survive and prosper in the long run if they focus
only on developing the capability to strategically manage within the economic context in order to generate shareholder returns. To the extent that environmental, social, and ethical outcomes are perceived at par with financial outcomes, companies need to become more sophisticated in their ability to survive, and indeed thrive, within the broader environmental, social, and ethical context. Therefore, the stated accountability in terms of outcomes will have to be reflected in the capability to manage within the broader socio-environmental context, in addition to successfully managing within the narrower economic context.

Consequently, sustainability and social responsibility cannot and should not be viewed as concepts that are independent of, separate from, or peripheral to the foundational strategic problem. Quite the contrary: they constitute critical new elements that call for its fundamental reconceptualization. Therefore, in the age of sustainability and social responsibility, strategy is about building a sustainable competitive advantage in the long run through the concurrent and synergistic co-generation of financial as well as broader environmental and social value. Equivalently, strategy is about embedding and understanding non-financial outcomes as integral to a company’s performance in addition to financial outcomes, and it is about building the tools and frameworks to co-manage the socio-environmental context in conjunction with the economic context. Thus, contemporary strategy is a more complex and multi-dimensional area of inquiry and practice, and critically, strategy effectively lies at the intersection and indeed characterizes the role of the corporation within civil society in the long run.

Inevitably, the claim that a reconceptualization and redefinition of strategy is necessary raises the obvious questions: (a) What is the evidence that organizations exist that genuinely adopt and implement sustainable business models that strategically integrate social and environmental issues in addition to economic issues? And (b) to what extent are such organizations more likely to survive in the long run? In other words, does a distinct type of
modern business organization, the sustainable organization, exist, and if yes, in what ways is it different from more traditional organizations? These are the core research questions I set out to explore in our broader work with G. Serafeim and R. Eccles as well as in our paper “The Impact of Corporate Sustainability on Organizational Processes and Performance” (Eccles, Ioannou, & Serafeim, in press).

More specifically, in this study we compared a matched sample of 180 U.S.-based companies, 90 of which we classify as high-sustainability (equivalently, Sustainable Organizations) and another 90 as low-sustainability (equivalently, Traditional Organizations). Our classification was based on the adoption of a broad range of environmental, social, and governance corporate policies in the early 1990s that, we argue, represent a genuine commitment to sustainability and social responsibility, years before such issues came to the forefront of the public’s attention. The sustainable organizations had adopted an average of 40% of these policies early on, while their counterparts had adopted only 10%. We selected these two sets of companies to be statistically identical on multiple variables including financial performance in the early 1990s, in order to explore whether and in what ways sustainable organizations were different from traditional ones over the longer term, and to also examine and potential performance differentials.

Using proprietary data from a multitude of resources, we found that sustainable organizations were characterized by a governance structure that explicitly and directly took into account the environmental and social performance of the company, in addition to its financial performance. They were significantly more likely to assign responsibility to the board of directors for sustainability and to form a separate board committee for sustainability. They were also more likely to make executive compensation a function of environmental, social, and external perception metrics. Second, we found that sustainable organizations paid particular attention to their relationships with stakeholders—such as employees, customers,
and NGOs representing civil society—through active and deep processes of stakeholder engagement. Third, sustainable organizations were more likely to measure and report on environmental and social metrics in addition to their financial results. Their external communications were also more long-term-oriented. Not surprisingly, we found sustainable organizations to have more long-term investors than traditional organizations.

These differences in organizational structure and processes are also reflected in critical differences in long-term financial performance. Over an 18-year period, the sustainable organizations dramatically outperformed the traditional ones in terms of both stock market and accounting measures. The annual above-market average return for the sustainable organizations was 4.8% higher than for their counterparts and was less volatile. Sustainable organizations also performed much better as measured by return on equity and return on assets.

Our research is a first but crucial step towards identifying and understanding the emerging new form of the modern business corporation, one that effectively and profitably integrates environmental, social, and ethical issues into its strategy in a way that enables the organization not only to generate financial returns for its shareholders but, indeed, to synergistically co-generate social and environmental value for the broader civil society. In other words, much work is still needed in terms of updating our tools and frameworks within strategy, and the broader management field, to be able to characterize more realistically the role of the corporation in society and to guide practitioners and academics alike.

This redefinition of strategy generates substantial implications for both research and practice. First, to establish a sustainable competitive advantage in the long run, companies need to engage in and explore a domain of problems (i.e., environmental, social, and ethical) that is relatively new and unfamiliar; it is therefore a domain that may potentially involve risks as well as great opportunities. Thus, the search for a new skill set and problem-solving
potential in uncharted territory has dramatic implications for human capital. Which set of knowledge and skills must leaders command in order to understand these issues and provide solutions in an integrated and holistic manner? More broadly, future research should also focus on understanding the role that top management, and the CEO in particular, play in their organizations’ inclination to adopt, implement, and integrate issues of sustainability and social responsibility in their strategy. Some excellent recent work has begun to consider the influence of such factors as the CEO’s political ideology, cognition, charismatic leadership, and intellectual stimulation in the company’s adoption of responsible practices (Chin, Hambrick, & Treviño, 2013; Crilly & Ioannou, 2014; Waldman, Siegel, & Javidan, 2006), but more work is needed.

Second, it is imperative that we gain a better understanding of the dynamic and evolutionary processes through which environmental, social, and ethical issues are integrated into a company’s strategy. Across companies, differences may arise in the type and speed of adoption, as well as the sequencing of adoption, of such policies. Thus, engaging in clinical or process research that would shed light on these processes is vital. It is also imperative that both as practitioners and as academics we revisit our most basic tools, frameworks, and schools of thought, and that we update and enrich them to reflect the new realities, as well as an emerging new role of business within society; as argued in this essay, in their present form they appear to be unable to provide sufficient insight or guidance. To this end, research undertaken in the domain of strategy would have to extend beyond the traditional boundaries of the economic context, and should seek to deeply understand the demands for accountability along dimensions that the traditional corporation has not typically focused on managing.

Third, there are significant implications for organizational design and structure. At present, most organizations do not formally consider sustainability to be an important
company-wide goal, or, at best, they see strategy and sustainability as two separate, if not antithetical, concerns. To what extent will this separation by function remain viable as companies are increasingly pushed to consider the needs and wants of multiple stakeholders? How separate should the roles of the chief financial officer and the chief sustainability officer be? How should organizations structure their reporting and monitoring routines to encourage the pursuit of both goals throughout the company hierarchy? Answers to these questions have the potential not only to transform our understanding of sustainability and CSR but also to alter the concepts of strategy and performance themselves.

In conclusion, strategy in the age of sustainability and social responsibility fundamentally challenges the way we have traditionally understood the role of the corporation within civil society. Its redefinition and reconceptualization may contribute significantly to a better and deeper understanding of the fundamental strategic problem today. In doing so, it may well direct both research and practice towards exploring the dynamic mechanisms through which the sustainable organization can and may positively contribute to resolving the global challenges we face today in the form of acute global social, environmental, and ethical issues.

1 I note that a historical overview of how strategy conceptualizations have evolved since ancient times, when they predominantly referred to war tactics, is not useful for understanding how foundational elements of strategy today are shifting and therefore falls outside the scope of this essay.

2 Interestingly, the authors indicated that the fragment “to enhance the performance” is the only fragment that fails to differentiate strategy from other fields of inquiry such as organizational behaviour or organizational theory. However, this is largely because
performance is important at the level of the individual in these other fields, whereas for
strategy, performance is primarily a firm-level construct.

3 Such diversity of opinion and differential emphasis on different concepts, however, clearly
highlights the interdisciplinary nature of strategy as a field, as well as the complexity of the
underlying questions that it seeks to address. Both scholars and practitioners enter strategy
from a variety of backgrounds and disciplines, bringing with them a diverse set of skills and
knowledge that is fundamentally required to successfully address core strategic questions.

4 There is also some discussion in the literature regarding the nature of the rents that accrue to
the firm as a result of its resource base. Specifically, Mahoney and Pandian (1992) defined
three types of rents that are relevant for the RBV as follows: (a) Ricardian rents, that accrue
to the owners of valuable and scarce resources; (b) monopoly rents, that accrue to
government-protected firms or firms in a collusive agreement; and (c) entrepreneurial rents,
that accrue to those firms that are able to successfully innovate. Entrepreneurial rents can
plausibly be sustained in the long run only to the extent that they also lead to Ricardian rents;
otherwise, imitators could compete away the innovator’s profits. Monopoly rents are often
illegal and sufficiently inefficient that, as Mahoney and Pandian (1992) argue, a reasonably
democratic and non-corrupt government would abolish them. Consequently, RBV scholars to
date have predominantly concentrated on the first type: that is, the acquisition, building up,
and maintenance of Ricardian rents.

5 In addition to this arguably distinct type of innovation, stakeholder theory scholars regard
entrepreneurship as another equilibrating force that may offer new alternatives to
stakeholders whose needs are being neglected by existing arrangements (Freeman et al.,
2010). Thus, the argument continues, entrepreneurial activity creates and destroys equilibria
and thereby continually serves and trades off the interests of multiple and diverse
stakeholders presumably at a level above that of the firm.
Importantly, Friedman (1996) suggested that an externality is anything that is not fully compensated for and that cannot be compensated for, and that thus may lead to a complete breakdown of a market (Becker, 1971). For instance, this may occur when there is no way to charge consumers for a product once the product has been produced. In other words, at the end, the goods and services are neither produced nor consumed, even if it would be (socially) efficient to produce or consume them, because the private cost of producing them is higher than the private value created, although the social value is greater than the social cost.

The term “circular economy” refers to an industrial economy that relies on renewable energy, aims to minimize waste, and works to eliminate the use of toxic chemicals through the careful design of production and consumption of goods and services (McDonough & Braungart, 2002; Towards the Circular Economy, 2013).

This body of literature is quite large, and it falls well outside the scope of this essay to attempt a full and detailed discussion of it. Influential meta-analytic articles such at Margolis et al. (2007) already provide excellent and comprehensive reviews of the entire literature. Here, my goal is to only sketch the trajectory of the existing research work to date and, to highlight its major shortcomings, particularly as they relate to the separation fallacy.

Examples of environmental policies included carbon-emissions-reduction policies, green supply-chain policies, and energy- and water-efficiency strategies. Social policies included diversity and equal opportunity targets, work-life balance, health and safety improvement, and favouring internal promotion. Policies related to community included corporate citizenship commitments, business ethics, and human-rights criteria. Finally, other policies we accounted for related to customers, product risk, and customer health and safety.
References


