DOES ENVIRONMENTAL MANAGEMENT IMPROVE FINANCIAL PERFORMANCE?

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Abstract: *The relationship between corporate environmental performance and financial performance has received a high degree of attention in research literature and the results are still contradictory. Most of the findings have shown that environmental performance improves financial performance while others have suggested that the relationship is neutral or even negative. Our article integrates prior research studying this relationship and identifies the potential moderators that may have played a role in the apparent inconsistent results observed to date.*

Keywords: *environmental performance, natural resources-based view theory, environmental management, meta-analysis, research synthesis.*

A large number of firms have implemented environmental practices that go far beyond environmental regulation in order to reduce their energy consumption, to propose green products or technologies to their consumers, and to minimize their ecological footprint. To that goal, most of these companies have adopted environmental management that encompasses the technical and organizational activities undertaken by the firm for the purpose of reducing environmental impacts

and minimizing their effects on the natural environment (Cramer, 1998). Therefore, environmental performance is the output of environmental management, and refers to the effects of the firm's activities and products on the natural environment (Klassen & Whybark, 1999). From these definitions, corporate environmental management (CEM) can be understood as a concept that embraces environmental management, environmental disclosure, and environmental performance. From the perspective of managers, the link between CEM and corporate financial performance (CFP) is not straightforward (Bansal, 2005; Sharma, 2000). Environmental management involves significant investment and important modifications of manufacturing processes in order to reduce pollution and energy consumption and/or to use renewable sources of energy rather than fossil fuels. As these environmental investments increase production costs that cannot be reported in the product selling prices, they negatively affect the CFP (Klassen & Whybark, 1999). Moreover, good environmental performance may take time to come to fruition, increasing uncertainty about outcomes (Aragon-Correa & Sharma, 2003; Hart, 1995; Khanna & Damon, 1999). Nevertheless, CEM practices are also considered as a way of increasing CFP. Since pollution is regarded as the sign of an incomplete, inefficient, or ineffective use of resources (Porter & van der Linde, 1995a), control and pollution prevention strategies can allow companies to make significant cost savings. Product stewardship, integrating the voice of the environment into product design and manufacturing processes, can lead to a competitive advantage through a "first mover" strategy in emergent green market products (Hart, 1995).

A number of studies have proposed conceptual frameworks or explanations for the existence of a causal relationship between CEM and CFP. Numerous studies have suggested that the relationship is positive (Al Tuwaijri, Christensen, & Hughes,

2004; Hart & Ahuja, 1996; Judge & Douglas, 1998; Montabon, Sroufe, & Narisimhan, 2007; Russo & Fouts, 1997; Sroufe, 2003; Stanwick & Stanwick, 1999) following Porter's "win-win" argument and natural resource–based view theory (Hart, 1995; Hart & Dowell, 2011). However, other research has concluded that CFP is negatively associated with CEM over a short period of time (Blacconiere & Patten, 1994; Jaggi & Freedman, 1992); and with proactive environmental strategies over a longer period of time (Cordeiro & Sarkis, 1997; McPeak, Devirian, & Seaman, 2010; Yu, Ting, & Wu, 2009). Yet other studies have established that the relationship between CEM and CFP cannot be proved because of the difficulties of measuring the environmental management consequences on profitability (Collison, Lorraine, & Power, 2004; King & Lenox, 2001; Murray, Sinclair, Power, & Gray, 2006). Even though the results of previous empirical research remain contradictory, the relationship between CEM and CFP seems to be positive. Therefore the research question worth studying is "When does it pay to be green?" rather than "Does it pay to be green?" Research findings are influenced, among others factors, by sampling size across studies, industrial context, inconsistent measurement of CEM and CFP, different research methodologies, and varying procedures for data collection and analysis. Most research on the relationship between CEM and CFP has used market-based or accounting-based measures of financial performance. Some have used perceptual measures of financial performance based on organizational capabilities such as product stewardship, or environmental innovation (Hassel, Nilson, & Nyquist, 2005).

Moreover, as research in the area of environmental management has increased, various proxies have been utilized to measure CEM (Walls, Phan, & Berrone, 2011; Yu et al., 2009). Most studies have used negative externalities

(Earnhart & Lizal, 2007; Hart & Ahuja, 1996); some have used data reported from the Toxic Release Inventory (Clarkson & Li, 2004; Dooley & Lerner, 1994; Hamilton, 1995); some have used voluntary participation in environmental programs (Dowell, Hart, & Yeung, 2000; Khanna & Damon, 1999); yet others have used rewards or similar recognition (Klassen & McLaughlin, 1996) or environmental disclosure (Blacconiere & Northcut, 1997; Cohen, Fenn, & Konar, 1997). These different proxies focus on specific goals of CEM practices such as maintaining legitimacy, conforming to environmental regulation, or improving environmental performance. Thus, a close examination of research findings is critical for furthering knowledge in this area. Global businesses have started employing different environmental management practices (EMPs) to mitigate the effects of surging environmental threats (Tene et al., 2021). The findings of recent studies have confirmed that industrial firms play a concomitant role in the destruction of the ecological system and regulators, business managers, and scholars are exploring various methods to combat these issues (Ali et al., 2022; Pinto et al., 2018; Shahab et al., 2020). The current global business environment is complex which has further enhanced the uncertainties about gaining a competitive advantage and survival without complying with environmental legitimacy and addressing the concerns of stakeholders (Shahzad et al., 2020). Simultaneously, scholars have suggested that strategic implementation of EMPs improves firms' environmental performance (EP) which alternatively contributes to improving the environment, social, and governance (ESG) and financial performance (FP) (Chen et al., 2018; Zheng et al., 2020).

Proactive implementation of EMPs involves, developing a management system by synergizing organizational structure, planning environmental initiatives,

sharing responsibilities, developing processes, and acquiring resources to implement, achieve, review and maintain an effective environmental policy (Aslam et al., 2021). The evidence of theoretical studies predicted that organizations' voluntary commitment to environmental initiatives helps in gaining a competitive advantage by leveraging strategic resources (Zhang and Ma, 2021) and seeking a wider social acceptance by legitimatizing environmentally-driven operations (Elzinga et al., 2020). According to resource-based view (RBV) and stakeholder legitimacy theories, consistent organizational commitment of good EMPs may improve their EP which improves ESG and may result in financial benefits, competitive advantage, improved reputation, and positive brand image. RBV and institutional theories under similar settings further argued that the organizational commitment of good EMPs cajoles managers to develop environment-friendly initiatives which lead to better EP, ESGD, and improved FP (Feng and Wang, 2016; Hart, 1995; DiMaggio and Powell, 1983). Additionally, commitment to good EMPs leads to developing and maintaining an effective business connection.

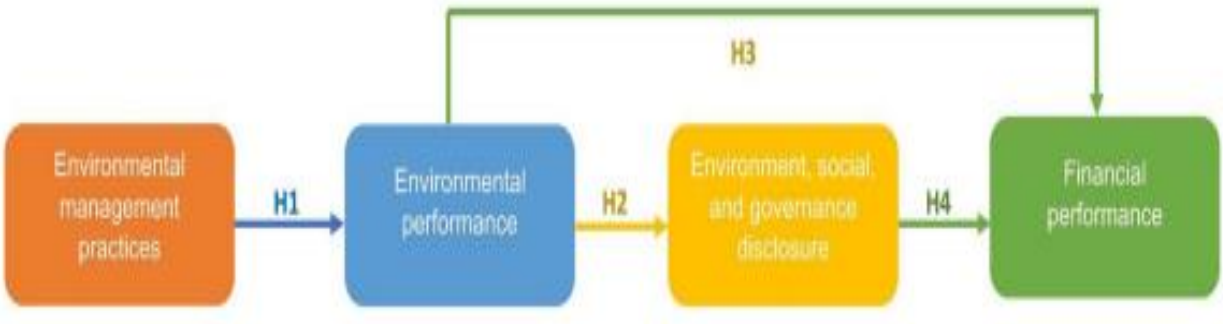

Figure 1. Theoretical model.

After highlighting the corporate environmental performance and corporate financial performance, there are different categories of measurement of corporate environmental performance and corporate financial performance as shown in Fig.1. In Fig.1, CEP and CFP categories are combined from 63 empirical studies and analysed the correlation through vote counting. There are 110 correlations of different environmental performance on financial performance. There are 44 correlations (40%) using environmental pollution, 18 correlations (16%) using environmental disclosure and 48 correlations (44%) using environmental management. The four main financial categories are 61 correlations (56%) using accounting-based performance, 11 correlations (10%) using firm cost, 29 correlations (26%) using market-based financial performance and 9 correlations (8%) using business operation performance. For the measurement of environmental performance, the majority of researchers are using environmental performance and corporate environmental management, only 16% of relationship using environmental disclosure.

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