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Business Implications of Corporate Sustainability in an Emerging Country: Evidence From China

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This is an exploratory study, using case studies to explore the business implications of sustainability management in Chinese enterprises. Specifically, the study investigates how Chinese managers view corporate sustainability and corporate sustainability management in the changing institutional environment. The study explores the institutional factors that influence corporate decisions and actions to tackle sustainability management. Research findings reveal that sustainability study needs to consider the social and economic context of developing countries. Western business concepts need to be modified to be able to adapt to Chinese context. The findings point to the potential of using combined multi-institutional theoretical perspectives to research into corporate sustainability in a less developed country.

Keywords: China, Developing countries, Institutional Theory, Sustainability, Accounting

Field of Research: JEL Classification M41 Accounting

1. Introduction

Developing countries including China are increasingly important in the global discussion of the impact of corporate activities and the environment (ACCA and GRI 2009). In contrast to the great deal of research on corporate sustainability in the developed countries, there appears to be relatively limited research on corporate sustainability in developing countries (Islam and Deegan 2008; Kolk et al, 2008; Belal and Owen 2007; de Villiers and C.J. van Staden, 2006; Sharma, 2002; Belal, 2000; Williams and Pei, 1999; Gray, et al 1995a). There are concerns about generalising the results of studies in developed countries to developing countries (see for example Belal and Owen 2007) due to socio-economic differences between developed and developing countries. The sheer size of China and the volume of industrial activities indicate an important role China play in global sustainability problems (Schaltegger, Bennett and Burritt, 2006, p.2). China has maintained an average GDP growth of 10% per annum during 2003 and 2008 (World Bank, 2010) and is now the second largest economy after the United States (Wang and Li, 2010). However, the economic growth was achieved with social and environment costs (World Bank, 2007). Similar to many developing countries, China is in a more environmentally risky situation than its Western counterparts (Chan and Welford 2005; UNWCED, 1987) because priority was (and still is) given to economic development. Certain foreign

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investors have ‘transferred high-pollution and dangerous industries to China because of China’s weak regulatory environment’ (SustainAbility, 2007, p. 36).
Yet little is known about corporate sustainability in China. This lack of research motivates this study. Specifically, the study addresses the following research questions (RQ).

RQ1. How is sustainability viewed by Chinese senior executives?

RQ2. What are the business implications of corporate sustainability management for Chinese enterprises?

This study makes two distinct contributions to literature. First, it offers insights on how Chinese management of state-owned enterprises respond to corporate sustainability management in the changing institutional environment in China. Second, it offers important empirical evidence to support a multi-institutional theoretical framework to analyse corporate response to institutional processes in the context of developing countries. The rest of the paper is organised as follows. Part 2 reviews literature with a focus on Institutional Theory and sustainability. Part 3 outlines the research design. Part 4 reports on the findings and discussions. Part 5 concludes and provides directions for further research.

2. Literature Review

The meaning of ‘sustainability’ is evolving and shaped by social and organisational institutional forces (Jennings and Zandbergen 1995; UNWCED, 1987). The most common definition on sustainability is adopted from the United Nations World Commission on Environment and Development “Our Common Future” (UNWCED, 1987)

> Development that meets the needs of the present without compromising the ability of future generations to meet their own needs (p.43).

Prior literature suggests debates on sustainability be taken from “strong and weak sustainability” positions (Bebbington, 2001). Weak sustainability position holds that sustainability is achievable with incremental adjustment of the current system. External pressures and the advancement of technology will allow problems to be solved. In contrast, strong sustainability position has concerns on the role of technological development in sustainability, and holds that “technical fix may generate more side effects than they solve” (Bebbington 2001, p.140; also see Byrch et al., 2007). Strong sustainability position argues for a radical structural change in order to achieve sustainability. The weak sustainability position advocates a win-win situation for organisations and the society, and is increasingly recognised by literature (Laine 2005; Epstein and Roy 2003; Epstein 2008; Lynes and Andrachuk 2008; Adams and Frost 2008). This paper follows weak sustainability position to examine sustainability in China through the Institutional theoretical perspective which will be discussed below.

Institutional Theory in its various forms is a useful analytic framework in both management and accounting research (Dilliard et al., 2004; Ribeiro and Scapens

2006). Institutional Theory takes into account of the social and economic context in which an organisation is situated and examines the effect of institutional pressures on the organization. Those institutional pressures refer to as coercive pressures, normative pressures and mimetic pressures (DiMaggio and Powell, 1983). Scott (2001) developed a similar typology to describe institutional pressures regulatory, normative and cultural-cognitive elements. The three forms of institutional pressures are integrated in practice, although some of them may be more influential than the others at certain time (Hoffman, 1999; Scott, 2004). Institutional theory studies how these pressures are reflected in organizational practices and characteristics.

According to Scott (2001), institutions are

> social structures that have attained a high degree of resilience. Institutions are composed of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, providing stability and meaning to social life
> (p. 48)

Scott (2002) pointed out the definition ‘connote stability but are subject to change processes, both incremental and discontinuous’ (p.60). This view is compatible with the debates on sustainability from weak and strong position. One of the strengths of the theory is its attention to the context of accounting practice, therefore, the theory has the potential to characterize and explain important changes which are underway at national and international levels (Scott, 2004).

Earlier studies in Institutional studies were focused on the similarities (isomorphism) of organisation and had been criticised for its inability to address the change (Hoffman 1999; Moll et al., 2008). Similarly, in environmental accounting literature, Institutional theory has been applied to explain the intra-industry similarity (Cormier et al., 2005; Aerts et al., 2006), with little discussion about the changing process of institution. Recent development of the theory shows the theory can be useful to explain the change processes (Ribeiro and Scapens 2006). Ball and Craig (2010) extend the theory (in its sociological form) to explain corporate response to social and environment accounting in two organisations from Canada and England respectively.

Theory development advocates the converging insights of the contributions of rational efficiency-based and legitimacy-based institutional arguments (Oliver, 1991; DiMaggio and Powell 1991) into a more compact theoretical body of findings that enables researchers to understand corporate response to institutional pressures. For example, Oliver (1991) extended institutional theory by integrating resource dependence perspective to explain and predict corporate responses to institutional pressures. Peng (2003) advanced institutional theory by integrating strategic choices perspectives in explaining institutional transition in emerging economics. Scott (2004) proposed that studies consider both efficiency and legitimating arguments from the institutional framework rather than over-emphasis on just one element (Scott, 2004) in early institutional theory research. This study extends the prior institutional theoretical discussion to the empirical study of corporate sustainability management in China. Next section outlines the research approach.

3. Methodology and Research Design

This study responds to the call for 'engagement research' in sustainability accounting study through interviews (Adams and Larrinaga-Gonzalez, 2007; Parker, 2005) with senior Chinese executives in China. Interview approach helps to gain a richer understanding (O'Dwyer, 2002) of how management of large Chinese enterprises view sustainability management in the changing institutional environment in China where little research is known. There is 'a distinct lack of published studies based within developing countries which employ interview methodologies' (Belal and Owen 2007, p. 473). This study thus fills the gap by providing empirical evidence of managerial views on corporate sustainability in China. One of the key practical objectives of the study is to engage with Chinese managers in communicating corporate sustainability management (Belal and Owen, 2007). They may take the opportunity to review their practice and may consider taking actions to improve their practice.

The information gathered from interviews has been used to relate to publicly available documents in both English and Chinese languages, such as corporate annual reports, standalone corporate sustainability reports, government announcements and regulations to explore the institutional factors that influence corporate environmental management for enterprises in the China. Interviews included one focus group, followed up with semi-structured open-ended individual interviews conducted in China in October 2009 and July 2010 respectively (see Appendix 1 for the interviews list). Interviews covered how Chinese managers' view on corporate sustainability in the transition period in China; what are challenges and opportunities arising from corporate sustainability management; what factors motivate companies to commit to sustainability management and reporting.

The study was conducted in Liaoning Province, located in Northeast China. Liaoning was chosen because the province used to be and still is China's heavy industry center and host major large state-owned enterprises during the planned economy period between 1949 and 1978. Between 1950 and 1952, 18.5% of the then national industry infrastructure investment was located in Liaoning. State-owned enterprises (SOE) in Liaoning specialized in materials and heavy equipment manufacture. The total value of industrial assets in Liaoning was 53.1 billion Yuan (approximately US$9 billion) in 1983, ranking the top in China. Enterprises were owned by the state under planned economy between 1949 and 1978. The employment in former state-owned enterprises was not subject to demand and supply market relationship. Salaries and associated social benefits including free accommodation, medical care, retirement, and free education were allocated by higher administrative authority. The appointment of managers was not through market recruitment, instead, through state-government appointment (Walder, 1986, p.11, cited in Scott 2002 p. 73). As the assets of the enterprise belonged to the state, and there were no conflicting interests between management and workers.

Economic reform resulted in the institutional transition of China's economy from planned economy towards market economy. The State-owned enterprises pilot reform in China was carried out in Liaoning in late 1990s including the central government's announcement of the first bankruptcy case of its state-owned enterprises. As a result, the number of redundant workers in Liaoning alone was reported to reach 1.2 million, accounting for 12% of whole country's redundant workers (Liaoning Provincial Government, 2002). The primary objective of SOE reform was to improve financial viability of those enterprises, yet social costs of such reform perhaps have been compromised as redundant workers would lose their social benefits. Management on the other hand gain more control over the former SOE which creates conflicts of interests between management and workers. This presents a challenging issue to Chinese government and the management of former SOE to achieve sustainable development.

4. Discussion of Findings

4.1 Sustainability in the Context of China

Sustainability is interpreted as the 'scientific approach to China's development' (Central Communist Party of China, 2008). Recognizing the social and the environmental costs involved in the thirty years of economic reform since 1978, the Chinese government has started to see sustainability as a tool to adjust its economic development from fast economic growth primacy towards a balanced economic development with attention to social harmony. The following comment reflects on the Chinese government's call for the change of development approach

> …Sustainable development is about stable development without too many abrupt changes in development… G20 Summit proposes sustainable development as the approach to development…Economic development should be under control. Overheated economic development is not good for sustainable development (Comment 1).

The above comment implies an incremental change is preferred to radical change in order to achieve sustainable development in China. This aligns with the weak position of sustainability debates. Interviewees' comments on SOE reform revealed China's socialist capital market is modeled on Western capital market. However, Western business models without modification may not be suitable for Chinese context. The next section discusses the changing environment of Chinese SOE and its implications of corporate sustainability for Chinese management.

4.2 Institutional Changing Process of Chinese State-Owned-Enterprises

From 1978 to present, those formerly state-owned enterprises have experienced institutional change and been transformed into corporatized enterprises with a diverse types of ownership although productive assets were controlled by state (Hilmy,1999; Scott, 2002; Xu and Uddin, 2008). The reform of state-owned enterprises resulted in the establishment of capital market in China to raise funds for the then underperformed SOEs. Two stock exchanges which are Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) were established in 1990. The primary objective to establish stock exchanges is to promote market-driven economy and to separate the responsibilities of the government from the management of enterprises. Early listed SOEs were those financially underperformed enterprises, with productive ones controlled by the government. China's capital market adopted Western capitalist markets, however, the meaning of ownership and entity in China is different: it is ‘more of political and ideological consideration rather than an economic and legal one’ (Child, 1994, p.19, cited in Scott 2002, p. 70). The following extracts of the interviews shed some light on this

> It is inappropriate to use Western concept of privatization to understand Chinese state-owned enterprise reform in China…Privatization of state-owned enterprise in China means corporatization of those state-owned enterprises. Ownership is still controlled by the government, especially in Resources Sector, there are signs indicating the expansion of public ownership…(Comment 2).

> …Corporatized SOEs are owned by State Council’s National Assets Administration Commission, a semi-government organization (Comment 3).

The above comments are aligned with prior research in other developing countries (see Belal and Owen 2007) to question the relevance of Western business concepts to the context of developing countries.

4.3 Corporate Response to Sustainability Management and Reporting

This section reports and discusses management response to sustainability management and reporting in China from two perspectives: first, motives behind corporate sustainability management; second, the opportunities and the challenges in corporate sustainability management.

4.3.1 Motives

Prior research shows low voluntary disclosure on social and environmental related performance by Chinese companies (Li and Xiao 2002; Zhou and Sun 2006, Gao et al 2005, SustainAbility 2007) prior to 2006. In contrast, recent research (Syntao 2009) has shown a sharp increase in the number of Chinese listed companies in particular those state-owned listed companies started to publish their sustainability reports in 2008. The majority of Chinese enterprises used the title ‘Corporate Social Responsibility Report’ rather than ‘Sustainability Report’ in the report year 2008. The word choice implies the state-imposed responsibilities on Chinese government controlled enterprises and their management. The similarity in choosing the reporting title by Chinese companies indicates the existence of institutional pressures on the reporting companies (DiMaggio & Powell, 1983). What explains the quick change of Chinese enterprises to report sustainability performance? Interviews with Chinese managers help to gain better understanding on this question.

Interviews with Chinese managers revealed corporate response to sustainability management is influenced by integrated regulatory, normative and cultural cognitive institutional pressures at both local and international levels. Internationally, the demand from international market and learning from the best practice of the global companies are seen as one of the motivator of Chinese companies to report on sustainability management.

> …the international customer requires not just value for money, but also non-financial performance of Chinese companies. International market also evaluates the potential

> growth of Chinese companies; therefore, there is a demand for Chinese companies to report on sustainability performance" (Comment 4).

Locally, an increased central government regulation and guidelines together with increased public awareness on social and environmental issues influence Chinese enterprises to report on sustainability management. The management in state-owned enterprises in particular those central SOEs are appointed by Communist Party of China (CPC) Divisions of local or central government. The role of government as both the regulator and business owner implies the managers would have to comply with government expectations due to its dependence on the government.

The Chinese government calls for a '*Scientific Approach to Economic Development*' and sets a binding target to reduce its energy consumption per GDP unit by 20% in its 11th Five-Year (2006–2010) National Economic Development Program (Xinhuanet 2005). In May 2008, Shanghai Stock Exchange issued the '*Voluntary Corporate Social Responsibility Reporting Guide*' (SSE 2008) to encourage listed companies to report on corporate sustainability performance. The increased government regulations and guidelines on sustainability reporting exert pressures on management to respond to the call for corporate sustainability so that they could maintain their legitimacy and resource supply from the government. Characteristics of state-owned enterprises were discussed in the conversation with interviewees. The following comments provided insights on why SOEs in China report (or not report) on corporate sustainability performance.

> State-Owned Enterprises have to take 'social responsibility' because it is the duty of SOE in the Chinese social and political environment. Profits earned belong to the state…therefore it is a win-win solution to take corporate sustainability management…(Comment 5)

> Enterprises in China are facing two tasks, one is short-term oriented, which is about how to do things right; The other one is long-term oriented which is about how to be a good person. Chinese enterprises should aim for being a good person in the long term and build up reputation in the community which in turn will bring financial benefits to the enterprise (Comment 6).

The above comments are consistent with Oliver (1991). When an organization anticipates that conformity will enhance social or economic fitness, the organization will comply with institutional pressures, and thus to report on its sustainability performance.

However an organization may choose defiance strategy (non-disclosure) when both legitimacy and efficiency are low:

> Enterprises choose not to disclose information is due to the 'political concern' due to uncertainty….on the content of sustainable development. Too much exposure or disclosure of corporate sustainability issue may have the potential risk of attracting public scrutiny (Comment 7).

Managers of state-owned enterprises are CPC members, political correctness is what large SOE have to observe in China, where CPC remains unchallengeable power (Scott, 2002). This perhaps explains low disclosure of corporate sustainability reporting in 2006, when there were less government guidelines on state-owned enterprises compared to 2008 when increasing government regulation and more guidelines were available for enterprises to prepare for corporate sustainability reports.

4.3.2 Opportunities and Challenges

Reported opportunities of sustainability management appeared to emphasize the benefits of environment management system to the business with little mentioning of social benefits. Typical comments include improved product quality due to the implementation of the environmental management system and improved internal control environment. Corporate sustainability management also offers opportunity to provide new technologies, products or services and potential competitive advantages resulted from regulations on environmental protection, for example, the commitment to energy saving and emission reduction.

Challenges faced by Chinese enterprises include the identification of social and environmental performance indicators; the competing priority of local governments' pursuit of GDP growth and the need for protecting environment and maintaining social harmony; the role of state-owned enterprises as both economic entity and social benefits provider influenced by planned economy; and the tension between demand for economic development and resources shortage.

Unlike economic performance indicators, such as Gross Domestic Products (GDP), it is hard to quantify social and environmental performance. GDP had long been used as performance indicator by higher level of government to assess lower level local government economic performance. Thus, both enterprises and local government tend to be driven by financial performance rather than environmental protection. Just as one of the interviewees put it

> It is hard to compare and benchmark non-financial performance (Comment 7).

As noted in Walder (1986), employment in Chinese state-owned enterprises plays a welfare role in the planned economy. The evidence from interviews reveals some SOE still carry on the welfare providers' role. For example, some state-owned enterprises had to expand production during market recession in order to secure jobs for their workers. Production was not market driven but social security driven which leads to overproduction. Overproduction in turn resulted in the waste of resources, and hence became one of the dilemmas for Chinese managers in sustainability management. The dual role of state-owned enterprises is reflected in the following comment:

> Under the planned economy, an enterprise used to be responsible for not only production but also the social welfare of its employees and employees' family, for example, schools, hospitals used to be operated by enterprises in each industry. With decline in production, operating costs went uncontrollable, which contributed to the operating loss in most of the enterprises in the mining industry in China in the 1990s (Comment 8).

Chinese state-owned enterprises are still in transition, how to achieve economic efficiency while maintaining the social benefits to its employees? There is no easy answer.

5. Conclusion and Limitation

This exploratory study provides empirical evidence to understand the changing role of Chinese state-owned enterprises, by exploring management views on corporate sustainability management through interview approach. It fills the gap of sustainability accounting research in the world's largest developing country. It extends prior institutional research by drawing on an integrated approach of efficiency and legitimacy arguments to explore business implications of corporate sustainability in China. The research findings reveals that although China's capital market models Western capitalist market systems, the country's past institutional environment influences its current corporate sustainability management. The taken-for-granted institutions under the planned economy are being challenged and gradually replaced by emerging institutions. Increased international operation and foreign investment in China brings non-local knowledge to Chinese companies, which in turn appear to influence Chinese enterprises corporate sustainability management and reporting practice. The study indicates the need for understanding the broader social and economic context of corporate sustainability management in developing countries. The study has its implications in policy making as the findings will inform policy-makers and corporate management to take the opportunity to review their sustainability management practice and consider actions for improvement.

The paper is focused on exploring management views on corporate sustainability in the context of China and is descriptive by nature. The findings are limited to case studies in one region, thus generalising the results is not possible at this stage. The findings point to the potential of applying Institutional Theory to the study of corporate sustainability research in China. However, how institutional factors at different levels interact with each other to influence (and be influenced by) companies is not fully explored in this paper. Future study needs to develop a comprehensive theoretical framework to analyse corporate response to institutional influences in a developing country. For example, future research can involve a cross-industry and cross-time analysis of Chinese companies' sustainability reporting practice and examine the change of reporting practice from Institutional theoretical framework. The author is undertaking another research project aiming to address some of the above limitations, and will report on the findings in due course.

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Appendix 1 Interviews Summary

Interviews	Designations of Interviewees	Type of Company	Industry
Focus Group Interview	Participant 1 Chairman and Managing Director Participant 2 Deputy Managing Director Participant 3 Chief Executive Officer Participant 4 Overseas Division Director Participant 5 Logistics Manager Participant 6, Division Director Participant 7 Deputy Division Director Participant 8 Retired Director	State-Owned Enterprise State-Owned Enterprise Listed State-controlled company State-owned enterprise State-owned enterprise State-Owned enterprise State-Owned enterprise State-Owned enterprise	Material – mining
Individual interviews	Interview 1 Chairman and Director	State-owned enterprise	Material – Mining
	Interview 2 Chairman and Director	State-owned enterprise	Material – Mining
	Interview 3 Public Relations Division Manager	Joint Venture	Consumer Discretionary
	Interview 4 Production Manager	Listed company – non-government owned	Capital Goods