FOR WHOM IS THERE A PROFIT MOTIVE TO DO GOOD FOR THE POOR?

AN EXTENDED BASE-OF-THE-PYRAMID PERSPECTIVE.

ABSTRACT

In this study we explore and empirically test how the quality and familiarity of institutions set boundaries to the performance of firms operating at the Base-of-the-Pyramid (BoP). We propose that poverty sets unique conditions, which make the level of institutional quality a critical factor that influences the relationship between the firm's social and environmental impact and financial performance. We also propose that firms from low-income countries can be conceived as more familiar with the institutions at the BoP than multinationals from high-income countries. Thus, we propose a revised BoP perspective that addresses the involvement of actors from developing countries at the BoP, including emerging country multinationals and local small-scale producers and the critical role of local government institutions. To test our theoretical framework we collected -in cooperation with NGOs, development organizations, and micro-finance institutions-, a unique dataset of 143 firms operating in BoP markets across 105 countries. Through our analysis we find support for our revised BoP perspective with respect to social impact, however, we do not find support with respect to environmental impact. The results also show that foreign firms outperform local actors, although multinationals from low-income countries do better than those from high-income countries. We discuss the important implications of this finding for the further development of the BoP management perspective.

INTRODUCTION

There is a growing body of research, known as “base of the pyramid” or “bottom of the pyramid” literature, which explores opportunities for the private sector to do well by doing good for the poor. The base of the pyramid (BoP) refers to a socioeconomic group of deprived people in developing nations that comprise the “underclass” of society (e.g., London & Hart, 2004; Prahalad, 2005; Prahalad & Hart, 2002). The BoP literature asserts that the size, unique characteristics, and underdeveloped economic activity of the BoP offer the private sector opportunities for growth, innovation, and profit with positive social and environmental spillovers (e.g., de Soto, 2000; Hart & Christensen, 2002; Prahalad & Hammond, 2002). The idea of positive private sector involvement in the BoP has also caught the attention of leading international organizations such as UNDP (e.g., UN Global Compact) and the World Bank (e.g., IFC), think tanks (e.g., WBCSD and NextBillion) and NGOs. Furthermore, this idea has gained traction in the international political agenda. For example, the UN Millennium Declaration -signed by 189 Heads of State and governments from the North and South- ascribes a pivotal role to the private sector in the attainment of the Millennium Development Goals (Pearce, 2005; Sachs, 2005).

The idea that firms can approach the BoP market as a potentially attractive market – a market with opportunities for entrepreneurship, market entry and growth, innovation, labor and much more – is not uncontested in the literature. We only have to think of sweatshops and we understand that there’s also the possibility of making a profit by exploiting those living in poverty. A fundamental assumption in the BoP literature is that if firms pursue business opportunities at the BoP in a way that create social and environmental value, this will positively affect their financial performance (e.g., Hammond et al., 2007; Hart, 2005; Letelier et al., 2003; London & Hart, 2004; Prahalad, 2005; Rangan et al., 2007; Seelos & Mair, 2007; Viswanathan et al., 2007; WBCSD, 2004). This common idea shared by the BoP literature has also been summarized as “doing well by doing good” (e.g., Prahalad, 2005; Karnani, 2007a). This original BoP idea was innovative because thus far most private sector initiatives have either been philanthropic in nature or have primarily focused on the relatively rich in developing countries, thereby contributing to poverty alleviation primarily through a trickle-down effect. Previous poverty alleviation approaches have not viewed the poor as a potentially attractive market opportunity, because they have operated from the assumption that it is impossible to make an attractive profit at the BoP and at the same time improve the living standard of the poor (Ellerman, 2005; London, 2008). Rather than develop economically viable businesses, these traditional perspectives approach the BoP as a group in need of one-sided, top-down assistance (Chambers, 1997;

Stiglitz, 2002). Philanthropy and grant-based programs, for example, do not use mutual value creation as an instrument to improve poor people's lives. Unlike BoP firms, typical poverty alleviation approaches do not aim to develop a competitive advantage from this developing market (London, 2008).

Yet, the BoP management perspective has been the object of intense debate and scholars have questioned the validity of this idea underlying the BoP literature (Karnani, 2007a,b; Landrum, 2007; Walsh et al., 2005). A systematic empirical examination of the validity of the fundamental theory of the BoP has not yet appeared in the literature nor a discussion and empirical examination of its boundary conditions (Bruton, 2010). The present study therefore theoretically develops and empirically tests the foundations of the BoP literature. It also contributes to theory development by examining institutional transfer as means to alleviate poverty and conceives institutional quality as an important boundary condition for inclusive strategies in low-income markets.

Recent scholarly research emphasizes the role of institutional contingencies in the resource-based view of the firm (e.g. Aragon-Correa & Sharma, 2003; Brush & Artz, 1999; Brouthers et al., 2008; Oliver, 1997; Verwaal et al., 2009). For example, Brouthers et al. (2008) showed that resource-based advantages are dependent on the country-level institutional environment. This contingent resource-based view links the value of the firm's unique resource advantages to the institutional environment in which it operates. In this study, we will apply this approach in the context of the BoP and we explore the role of the multinational in institutional transfer and the quality of the institutional environment as a contingency of resource advantages at the BoP. First, the BOP perspective originally was a call for developed country MNEs to target BOP markets and thus help alleviate poverty. However, many BOP initiatives appear to be initiated by local rather than multinational firms. In this study we will theoretically explore and empirically test how the notion of local versus foreign could be integrated in the BoP perspective. Furthermore, in line with a recent surge in research on developing country multinationals (Guillén & García-Canal, 2009; Luo & Rui, 2009; Ramamurti, 2012), we propose a distinction between multinationals from high- and low-income countries as MNEs from low-income countries can be conceived as more familiar with low-income countries. Finally, the original BoP perspective did not address the critical role of institutions at the BoP. To date no systematic efforts have been made to evaluate the role of institutional context on the social/environmental performance and financial performance relationship. We submit that the quality of institutions may be important for the success of BoP initiatives and research needs to specifically explore and empirically test if they set boundaries to the performance of firms operating at the BoP. Failure to take into account the impact of institutional effects at the BoP may lead to incorrect conclusions about theoretical relationships and inappropriate strategic prescriptions for managers (Khanna & Palepu, 1997),

whereas studying the institutional differences within the BoP context may inform extant theory on the role of institutions and significant theory boundaries.

Thus, we propose a fundamental revision of the BoP perspective that addresses the role of local versus foreign firms, MNEs from low-income versus high-income markets and the critical role of institutions. Our novel approach addresses the involvement of actors at the BoP from developing countries, including emerging country multinationals and local small-scale producers and the critical role of local government institutions. The paper will subsequently set the theoretical scene and develop appropriate hypotheses, before empirically testing these hypotheses and drawing conclusions from them.

THEORY AND HYPOTHESES DEVELOPMENT

Social performance at the base of the pyramid

The extant literature suggests different theoretical explanations of a positive relationship between social performance and financial performance. Firms can reduce transaction and agency costs—including search and information costs, bargaining costs, and monitoring and enforcement costs—through social initiatives that foster trusting stakeholder relations (Jones, 1995). Social performance can also increase the value of the firm's resources such as reputation and human resources (Russo & Fouts, 1997), or firms may create value if they effectively supply a demand for social value propositions (McWilliams & Siegel, 2001). These different theoretical explanations each suggest a positive relationship between social and financial performance and several reviews of the empirical evidence support a small but positive relationship (e.g., Orlitzky, Schmidt, & Rynes, 2003; Margolis, Elfenbein, & Walsh, 2007).

There are many reasons why this positive relation reported in the extant literature may also apply at the BoP. Individuals at the BoP typically do not view value creation at the economic, social and environmental level as isolated spheres of activity. For example, Viswanathan et al. (2007) discuss the blurring of economic exchanges and personal social relationships at the BoP. A "shared sense of facing adversity" creates a "1-1 environment with strong word of mouth effects" and a central role for fairness and trust, making "individuals respond to fairness in relationships at a human level rather than at the level of abstract notions of competition, reflecting their immediate needs and life circumstances" (Viswanathan, Seth, Gau, & Chaturvedi, 2007, p. 5). Consequently -while the poor are already inclined to distrust organizations, such as private sector firms, that fall beyond the small circle

of the extended family (Banerjee & Duflo, 2007)- the need for legitimacy and support pushes firms to conform to social and cultural pressures and comply with the social norms of specific BoP communities (e.g., Scott, 2008). Growth at the expense of the poor is likely to meet vigorous resistance (Stiglitz, 2002) from potential partners at the BoP, such as NGO's and local community groups, which have a strong social orientation and may require comparable dedication from the private sector (Chambers 1997, London and Hart 2004). Disregarding social expectations at the BoP would only exacerbate distrust and increase the transaction and agency costs with the firm' stakeholders (Jones 1995), which would ultimately negatively affect financial performance. Therefore, addressing social concerns within the BoP environment and thereby strengthening its social networks may be a particularly profitable strategy.

Catering to the needs of stakeholder constituencies can augment a firm's reputation (Fombrun & Shanley, 1990), establish legitimacy (Ahlstrom & Bruton, 2001), create social capital (Narayan & Pritchett, 1997), and consequently contribute to firms' financial performance (Donaldson & Preston, 1995; Jones, 1995). Furthermore, value propositions with a social component are more likely to increase the productivity of people at the BoP if, for example, they improve people's health and abilities, as well as their sense of economic and social security. A firm can benefit financially from such social improvements through, for example, increased labor productivity and motivation of its employees, and higher-quality supplies. Therefore, from a resource-based perspective, the value of firm resources such as reputation, social capital and human resources can be enhanced by social and environmental performance at the BoP.

Demand for social value may also be higher at the BoP. Social needs are pressing at the BoP because of the low standard of living (Banerjee & Duflo, 2007; Hammond et al., 2007). Where living standards are low, people tend to choose value propositions with a large social component -those that contribute to employment opportunities, the development of public services, the accessibility of primary life necessities, etc.- over value propositions that contribute less (directly) to their standard of living (Chambers, 1997; Hart & Milstein, 2003; Sen, 1999). People in BoP communities first and foremost seek offerings that make a positive social contribution to their lives. They are willing to pay for such offerings, as social value is a prevailing and pressing need.

Hypothesis 1a. A firm's social performance is positively related to the firm's financial performance at the base of the pyramid.

Environmental performance at the base of the pyramid.

In general, non-shareowner constituencies not only value and monitor firms' social impact but also their environmental impact, thereby influencing firms' reputations, legitimacy, and social capital (Sharma & Vredenburg, 1998). Moreover, natural resources such as water, energy, and transportation can be scarce and expensive for companies. Consequently, environmental performance may improve a firm's cost efficiency by, for example, reducing energy needs and enhancing the renewability and durability of products, ultimately improving the firm's financial performance (Hart, 2005, Porter & Van der Linde, 1995). There are several arguments why the environmental performance and financial performance relationship may be more important in the context of the BoP.

First, the natural environment may be an even more prevailing concern among citizens at the BoP (e.g., Hart, 1997, 2005; Prahalad, 2005). The environment is a daily lifeline for the poor. "Harvests from forests, fisheries, and farm fields are a primary source of rural income, and a fall-back when other sources of employment falter" (World Resources Institute et al., 2005, p. 3). "As subsistence and small-scale farmers and fishermen, they [the BoP] are uniquely vulnerable to destruction of the natural resources they depend on" (Hammond et al., 2007, p. 5). Hence, the livelihood of many people at the BoP is directly dependent on the natural environment, one of the few assets available to low-income people. Thus, while everyone is affected by ecosystem degradation, the poor suffer disproportionately (World Resources Institute et al., 2005).

Second, meeting the challenge of environmentally sustainable economic development for the poor requires creativity and imagination. To this end, firms increasingly recognize that "listening to the voices of the poor and disenfranchised can be a source of creativity and innovation" (Hart & Milstein 2003, p. 63). Through such creative processes, firms engage in innovation and develop new capabilities that lower risks (Hart & Milstein, 2003), generate a source of differentiation (WBCSD, 2004), improve managerial practices, speed up regulatory approvals, enhance employee morale, and ultimately enhance competitiveness (Porter & Van der Linde, 1995; Russo & Fouts, 1997; Sharma & Vredenburg,1998).

Third, environmental resource constraints can easily intensify at the BoP because of its sheer size (Hart & Milstein 2005, World Resources Institute et al., 2005). Environmental concerns may therefore be of crucial importance to stakeholders in the BoP environment (Hart, 1997, 2005). Limited natural resources make it difficult to imagine including the BoP in the formal market system using the same resource-intensive business models currently employed in rich markets. Because of potential environmental problems, limited natural resources, the widening gap between poor and rich, and the intrinsic value of nature, growth at the expense of the environment is likely to encounter substantial

resistance (Hart & Christensen, 2002). Moreover, in the long run, failure to reduce the environmental footprint of economic development at the BoP could result in resource scarcity and require costly environmental restoration initiatives, which the BoP cannot afford. Therefore, based on the reasoning of various explanations in the literature we expect that environmental performance is positively related to financial performance at the BoP.

Hypothesis 1b. A firm's environmental performance is positively related to the firm's financial performance at the base of the pyramid.

Institutional quality and firm performance at the BoP

The idea that firms' social and environmental value creation positively impacts financial performance is not uncontested in the BoP literature (e.g., Jenkins, 2005; Karnani, 2007a,b; Landrum, 2007; Walsh et al., 2005). Through anecdotal evidence it is shown how firms can abuse the conditions at the BoP and make a profit at the expense of the poor (Karnani, 2007a). Sweatshops are, for instance, an extreme example of how firms can supposedly make a/more profit by exploiting the poor.

Institutions thus become a critical constraint in the long-term performance of an economy and cause performance variation across firms (North, 1990; Park et al., 2006). Hence the more deficient a country's governance system, the larger the formal institutional hazards faced by firms operating in that country (Slangen & Beugelsdijk, 2010). Research suggests, for instance, that social adaptation activities have significantly positive effects in mitigating firms' public crises (Zhao et al., 2014). Firms' responses to (unexpected) variation in the institutional environment of an investment also capture a significant share of senior managers' time and are a key determinant of success and failure (Henisz & Swaminathan, 2008). In short, institutions not only affect firm behavior but also competitive performance (Eden, 2010).

Therefore, the quality of the institutions at the BoP might change the nature of the relation between social and environmental performance, and financial performance. In the absence of institutions monitoring and reporting on firm behavior, the real level of social and environmental good or wrongdoing is difficult to see for the poor because they lack the financial resources and education to gain access to reliable information. Furthermore, given their lack of collective organization and their fragmented and heterogeneous nature (Dawar & Chattopadhyay, 2002), the absence of effective institutions are likely to cause the poor to disproportionally suffer from information asymmetries, lack of bargaining skills, and a weak position to gain access to information on social and environmental performance as stakeholders (Viswanathan, Seth, Gau, & Chaturvedi, 2007). A weaker power position

of the poor may reduce the incentive of firms to take the interests of the poor into account and build extensive trusting relations with them by creating social and environmental value.

Furthermore, in a weak institutional environment the poor may be in a weak position to penalize low social and/or environmental performance due to a lack of enforcement mechanisms or lack of access to these mechanisms. In some developing countries, government watchdog agencies are of little use and law enforcement tends to be capricious, slow, and ineffective (Khanna & Palepu, 1997). In spite of the fact that the livelihood of those at the BoP depends "directly on natural resources, they have few institutional instruments to influence how those resources are used, but suffer the consequences when the decisions are corrupt and the use is destructive" (World Resources Institute et al. 2005, p. 4). The concept of 'poverty penalty', which addresses access to products and services for the poor, may also apply to access to institutions and the poor will have even less access to institutional and social structures if they are subject to corruption. Companies may have fewer incentives to invest in positive social and environmental impact under these circumstances and may even be tempted to exploit the poor's vulnerabilities (Karnani, 2007a).

Although the poor are very much in touch with social and environmental issues and this enables them to quickly assess these dimensions, because of illiteracy or lack of education they may experience more problems in assessing the effect of social and environmental outcomes. Karnani (2007b, p. 97) argues that "[t]he poor are vulnerable by virtue of lack of education (often they are illiterate), lack of information, and economic, cultural, and social deprivations". Without the ability to access advanced information, the assessment of the exact level of social and environmental good is difficult. "Individuals and communities, within a given context, do not have the requisite skills, abilities or material means to obtain efficient access to information, interpret it and apply it appropriately" (Britz, 2004, p. 194).

In summary, social performance and environmental performance often come at a cost. If stakeholders at the BoP are unable to assess social and environmental performance or penalize low social and environmental performance effectively, this will lower the financial returns of social and environmental initiatives. Therefore the quality of institutions will positively moderate the social and environmental performance and financial performance relationship.

Hypothesis 2. A firm's relationship between a) social performance, and b) environmental performance and financial performance will be positively moderated by the quality of institutions at the base of the pyramid.

Local companies and multinational companies at the BoP

In their seminal work about the fortune at the bottom of the pyramid, Prahalad and Hart (2002) focus on Western multinationals because of their world-scale capabilities and advanced technology, and bring the attention of these multinationals to the potential profits. Prahalad and Hart (2002) conceptually build their model by referring to the existing systems in developed countries and the lack of such systems at the BoP.

In line with the resource-based theory of the firm, global reach, financial capital, and experience in technological product development were argued to be valuable capabilities to serve the poor's basic and elementary needs, which would improve the lives of the poor to such extent that they could escape from the poverty trap. Multinationals thereby appear to hold near insurmountable advantages over local businesses in developing countries (Khanna & Palepu, 2006). They not only possess efficient innovation processes and management systems, and sophisticated technologies but also have access to vast reservoirs of finance and talent. Internationalization is seen as a way in which multinationals can appropriate rents in overseas markets by exploring and exploiting valuable resources, such as technological capabilities, brand names and scientific knowledge (Wang, et al., 2012).

Strategic choices are not entirely driven by firm-specific resources that traditional strategy research emphasizes. Such decisions may also be the result of, or response to, the formal and informal constraints of a particular institutional framework in which a firm is embedded (Scott, 2008). This implies that we should take into account not only the role of resource-based characteristics, but also the institution-based view which considers strategic choices as the outcome of the interaction between institutions and organizations (Peng, 2002). Therefore, predictions rooted in the institution-based view suggest that a firm's internationalization strategy is shaped by the institutional framework of the home country of the firm (Cheng & Yu, 2008; Meyer & Peng, 2005; Peng, Wang, & Jiang, 2008).

Developing countries furthermore lack the soft infrastructure that makes markets work efficiently. Because of institutional voids—the absence of specialized intermediaries, regulatory systems, and contract-enforcing mechanisms— local companies in developing markets cannot access capital or talent as easily or as inexpensively as multinationals can (Rodrigues, 2013). That often makes it tough for businesses in developing countries to invest in R&D or to build distribution networks (Khanna & Palepu, 2006).

Multinationals not only have more advanced capacity, but the lack of adequate infrastructure in less developed countries provides the proper environment to develop sustainable innovation through technology leapfrogging and disruptive innovation. Prahalad and Hart (2002) point at the market opportunity for new-to-the-world innovations, and list the required changes in business models to

approach the markets of the poor: changing attitudes, working with partners or in consortia, creating a working force that is comfortable with working in BoP markets, creating separate investment funds, and moving research and development to less developed countries. A key assumption of the base-of-the-pyramid proposition is that foreign firms may usefully transfer their resources to the BoP market and therefore can reduce institutional voids and bring prosperity to the poor while at the same time gaining access to a large and profitable market.

Hypothesis 3a. A local firm will have a lower financial performance than a foreign multinational company at the BoP.

However, foreign firms also may suffer from a liability of foreignness (LoF), which implies that all else being equal, foreign entities are at a disadvantage or denied benefits available to their domestic counterparts (Zaheer, 1995). These costs affect the legitimacy or acceptance of the foreign firm relative to a local firm (Mata & Freitas, 2012; Bell, Filatotchev, & Rasheed, 2012; Zaheer, 1995). Typically, multinationals from developed markets have business models that are aligned to higher income consumers and information on developing markets is often insufficient and rules and laws are inconsistently applied due to an incomplete legal system and inefficient institutional enforcement. Consequently, firms cannot apply already-established procedures or extrapolate from past experience, especially in developing markets (Rodrigues, 2010). Even when firms institute corporate citizenship programs (Husted & Allen, 2006), questions regarding their moral legitimacy are accentuated by their foreignness (Bhanji & Oxley, 2013), suggesting that good intentions may not be sufficient for overcoming their LoF. For example, it is difficult for the foreign multinational company to establish quick and close relations with local actors. The firm is therefore not able to lobby for local government support, and does not have detailed knowledge to reduce the negative effects of local governments' discriminatory treatments imposed on outsiders (Qian, Li, & Rugman, 2013). Difficulties of being foreign may be very difficult for entities that lack such capabilities and are unprepared or unfamiliar with the host country (Zaheer, 2002). In addition to such organizational characteristics and capabilities, the overall foreignness effect can also be influenced by contextual factors (Joardar, Kostova, & Wu, 2014; Nachum, 2010), such as the specific setting of low-income at the BoP. In fact, institutional idiosyncrasies create market imperfections that may influence the value of resource-based advantages (Wan, 2005).

However, unlike what is often implicitly assumed in BoP literature not all foreign firms active at the BoP come from developed markets. Actually a considerable number of firms at the BoP find their origin in other BoP markets. Foreign firms coming from other developing countries may have

institutional advantages making resources and capabilities more tailored to local markets and institutions at the BoP. The disadvantage of foreignness may apply more to multinational from developed markets than for multinationals from developing markets (Cuervo-Cazurra & Genc, 2008). Hart (2005) brings previous work together to highlight the need for multinationals from developed economies to develop a capability for low-income markets, similar to what London and Hart (2004) call social embeddedness, however, there is actually little evidence that these firms do that successfully. Thus, multinationals from developed markets will have to put in more effort to overcome their liability of (high-income markets) origin and truly get to know the poor and the poor's market and how to deal with institutional voids of their living environments in order to develop successful BoP strategies. However, firms active at the BoP that have their origin in developing markets may have the advantage of a multinational company but also have business models that are more aligned with the institutional environment and needs of the poor at the BoP. Therefore we propose the following hypothesis:

Hypothesis 3b. A developing market firm will have a better financial performance than a developed market firm at the BoP.

DATA AND METHODS

Data

We conducted a survey of firms that have built businesses focused at the BoP. These are firms whose focal groups of customers, employees, suppliers, and/or distributors have an average daily purchasing power of $2 or less. Hence, the sample includes firms targeted at the poor as consumers as well as those targeted at the poor as producers (or both). We focused exclusively on for-profit businesses—i.e., firms intending to be profitable or at least self-financing through revenue generation. Firms were Western as well as local in origin and we included SMEs as well as initiatives by multinationals. An additional criterion was that firms should have at least 10 employees. We also required that all respondents held a general strategic position within the firm. To ensure a clear unit of analysis, the respondent was instructed to fill in the questionnaire for a single enterprise fitting the above criteria (e.g., a specific business unit, a specific joint venture, etc., or the entire firm if the firm did not consist of multiple clearly distinguishable enterprises).

Fourteen organizations[1] cooperated in this study and provided us with contact information for representatives of 518 firms fitting the above criteria. The diversity in the focus of these fourteen organizations (different industries and countries, national as well as international organizations, SMEs and multinationals), their different origins (western and nonwestern), and their different classifications (NGOs such as business networks, governmental organizations such as development organizations, and micro finance institutions) all facilitated the creation of a representative sample.

We followed the survey procedures laid out by Dillman (2000). Of the 518 firms, 84 responded that they did not fit the study's profile criteria, 14 pre-notice letters were returned as undeliverable, and nine firms responded that their level of English was insufficient to participate (and we did not have a participating organization in that region to assist them with the questionnaire). Of the remaining 411 firms, a total of 162 questionnaires were returned. Nineteen of these questionnaires were deemed to be of insufficient quality by the authors. This resulted in 143 usable questionnaires for the analyses, which corresponds to an effective response rate of 34.8%.

The respondents include firms from industries such as farming, healthcare, retail, financial services, private schools, and the energy sector (see Table 2). The majority of the companies come from developing countries, including India, Tanzania, Ethiopia, Brazil, Indonesia, Honduras, and Cameroon. Respondents have an average tenure of 6.9 years in their current positions and 11.3 years in their respective industries. Twenty-nine percent of respondents are the owner or partner and 45% are the CEO, director, or general manager. The average age of the enterprises is 14.3 years.

To test for non-response bias, we examined differences between early and late respondents (median split). We did not find any significant differences ($p > 0.46$) between the two groups based on financial performance, social performance or environmental performance. We also compared the representativeness of the sample with the population structure reported by Hammond et al. (2007), where we combined health, ICT and water into one category, and we found no significant differences. However, in our sample there are relatively more firms with energy (8.7% versus 5.6%) and housing activities (6.7% versus 3.5%).

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[1] World Business Council for Sustainable Development (WBCSD); Enterprise Ethiopia and Enterprise Uganda as part of UNCTAD-Empretec; SNV Cameroon Development Organisation and SNV Honduras Development Organisation as part of SNV International Development Organisation; Agency for International Business and Cooperation (EVD) (PSOM program); Business in Development (BiD) / NCDO; African Institute of Corporate Citizenship (AICC); Instituto Ethos de Empresas e Responsabilidade Social; PRIDE Tanzania as a partner of FMO; Cordaid; Oxfam Novib; and ICCO. The World Resources Institute kindly gave us permission to use the contact details on its website.

Measurement and Validation of Constructs

We undertook several measures to ensure the reliability and validity of the data (Thietart & Wauchope, 2001). On the basis of a literature study, continuous discussions with peers, and conversations with managers from organizations that work closely with firms at the BoP, we developed questions and generated pools of items for each construct. We pre-tested the questionnaire by seeking comments from academics and managers from organizations that focus on supporting firms that operate at the BoP. Then, we conducted six in-depth face-to-face interviews. Finally, we conducted a pilot study amongst 70 firms, which are included in the total sample size of 518; we found no reason to alter the questionnaire after this pilot study.

We examined reliability issues associated with single-informant data by surveying additional members of randomly-selected responding firms. Nine firms provided additional informants: three firms provided one additional informant, another three firms provided two additional informants, and three firms provided respectively three, four, and five additional informants. We calculated an inter-rater agreement score (r_{wg}) for each variable. The median inter-rater agreement ranged from 0.62 to 0.89, suggesting adequate agreement for aggregation as it exceeds the generally accepted cut-off point of 0.60 (Glick, 1985). In addition, examination of intra-class correlations revealed strong inter-rater reliability, as correlations were consistently significant at the 0.001 level (Jones et al., 1983).

Performance Measures. We developed formative scales for social and environmental performance, on which respondents indicated the impacts of their firms on the communities in which they operate. We used a seven-point Likert scale, ranging from “large negative impact” to “large positive impact”. We instructed respondents to focus only on the impacts of their core businesses and thus exclude the impacts of non-core activities such as philanthropic ventures. By excluding philanthropic ventures, we reduce the influence of financial performance driving social and environmental performance and instead focus on the relationship of social and environmental performance driving financial performance.

For *social performance*, we adapted items from the AtKisson Compass, which builds on the Global Reporting Initiative (GRI) and the Dow Jones Sustainability Group Index (DJSGI) (AtKisson & Hatcher, 2001). We complemented these items with additional items adapted from the International Association for Impact Assessment (IAIA). For *environmental performance*, we adapted items from the Environmental Sustainability Index (ESI) (Esty et al., 2005) and the AtKisson Compass. Social performance and environmental performance are respectively represented by five and two dimensions, with a total of 16 and 10 items. We measured *financial performance* using perceptual measures. Whenever possible, we collected accounting data on the net profit margin of each firm.

However, accounting data were often unavailable. Nevertheless, perceptual measures have been found to be useful alternatives and to correlate highly with the corresponding accounting measures (Venkatraman & Ramanujam, 1987; Wall et al., 2004). In support of this, we found a positive correlation ($r = 0.21$; $p < 0.01$) between perceptual performance and net profit margin among firms with available accounting data. We collected data on seven dimensions in order to capture the multidimensional character of financial performance (Venkatraman & Ramanujam, 1986). These dimensions were (1) sales growth; (2) customer satisfaction; (3) return on capital employed; (4) profitability and return on investment; (5) financial stability; (6) future prospects; and (7) overall performance. On each of these dimensions, we asked respondents to rank their firms' performance compared with similar firms in their industry on a seven-point Likert scale (ranging from "very poor" to "outstanding"). Table 1 presents all the items of the social, environmental and financial performance scales.

Institutional Quality. The world competitiveness report of the World Economic Forum is used in research as a reference to the institutional quality of a particular country (Delios & Beamish, 1999; Wan & Hoskisson, 2003; Xu et al., 2004; Gaur & Lu, 2007).

The quality and reliability of institutional infrastructures and legal frameworks are often assumed to be low at the BoP (Globerman & Shapiro, 2003; North, 1990; Wright et al., 2005), making monitoring of activities and contract and enforcement more difficult. Business regulations may change frequently and regulatory discipline may be lacking (Arnold & Quelch, 1998). However, according to the Global Competitiveness Report (GCR), countries with substantial BoP populations like Rwanda, Malaysia, Botswana and South Africa are more efficient in settling legal disputes and conflicts than certain high-income countries (GCR, 2012-2013; p. 397). This illustrates the considerable variation in the quality of institutions at the BoP where you can find institutionally high-ranked countries such as Rwanda (20), Malaysia (28) and Botswana (33), medium-ranked countries like India (70), Indonesia (72) and Brazil (79), and low-ranked countries like Madagascar (136), Yemen (139) and Venezuela (144). Moreover, in the lowest category you can also find higher income countries and countries subject to the presumably highly developed institutional frameworks such as the institutional framework of the EU (e.g., Greece ranking 111).

We used the methodology applied by Xu et al. (2004) to develop an institutional quality index (IQI) by performing a factor analysis on the indicators of the institutional pillar of the World Competitiveness Report. The institutional pillar consists of 21 indicators. We removed the crime related indicators that in our conceptualization are related to environmental hostility rather than institutional quality (1.13 Business cost of terrorism, 1.14 Business costs of crime and violence, 1.15 Organized crime). Environmental hostility can in fact be a reason to develop good and fair institutional

mechanisms as they alleviate the underlying social tensions that cause the hostility in the environment. A high ranked IQI country like Rwanda is a good example of this phenomenon and in Table 3 we observe that environmental hostility is positively and significantly correlated with institutional quality. The remaining 18 components of the factor analysis showed a factor loading of 0.77 or higher and the Cronbach's alpha is 0.97 suggesting satisfactory construct validity and reliability.

Table 1 goes about here

Control variables. We included measures to control for firms' industry and firm age and firm size. For firm size, we included a categorical variable that measured the total number of employees in each firm. We also included control variables to capture the dynamics of the business environment. Items for environmental dynamism are adopted from Achrol and Stern (1988). The psychometric properties of the scales suggest satisfactory reliability with alphas higher than .72 and composite reliability higher than .84. Furthermore, using confirmatory factor analysis with EQS 6.1 a satisfactory fit was achieved ($\chi^2_{13} = 42.403$, $p < 0.001$; CFI = 0.95; RMSEA = 0.07; 90% confidence interval of RMSEA: 0.05–0.10).

Common Method Bias. We examined whether common method bias might augment relationships by first performing Harman's one-factor test on the self-reported items of the constructs included in our study. The confirmatory factor analysis showed that the single-factor model did not fit the data well (CFI = 0.58; RMSEA = 0.27). Following Podsakoff et al. (2003), we conducted several additional tests. First, we performed a partial correlation method (Podsakoff & Organ, 1986) and found that added factors did not produce a significant change in variance explained in the dependent variables ($p > 0.56$). Secondly, we constructed a marker variable (BoP involvement), which is theoretically unrelated to the study's principal constructs (Podsakoff et al., 2003) and examined the correlations among all items of the study's principal constructs and BoP involvement (Lindell & Whitney, 2001). Since the average correlation between BoP involvement and each item of the principal constructs was r = 0.07 (average p-value = 0.38), this test confirms a lack of common bias. Finally, we should note that for hypotheses 2a and 2b we use different methods so the problem of common method bias does not apply to the test of these relationships.

We also conclude that there is no significant multicollinearity among the independent variables, as correlations between the independent variables are relatively low (see Table 3) and all VIF scores were below 3 and the matrix decomposition resulted in condition values under 20. The higher condition numbers showed factor proportions with values higher than 0.5. Similarly, no evidence of heteroscedasticity was detected. Finally, no significant outliers were found.

Table 2 and Table 3 go about here

ANALYSES AND RESULTS

We tested the hypotheses using hierarchical regression analysis. In Model 1 in Table 4, we present the control variables only. Next, we examine the fundamental theory of the BoP in three ways. First, we examine the relationship between social performance and financial performance (Model 2). Second, we examine the relationship between environmental performance and financial performance (Model 4). We followed this procedure because social performance and environmental performance are conceptually related constructs. For example, there are situations where social value creation also is an improvement in environmental value creation, and vice versa. As a result, there are items included in social performance that are environmental in nature and items in environmental performance that are social in nature. There are also situations where social value and environmental value conflict. For example, the protection of tigers and elephants increases biodiversity but may also decrease the physical safety and living standards of farmers in remote rural areas. Therefore, in our empirical exploration, we want to test the impact of social performance and environmental performance without the risk that they conflate each other's estimates. Subsequently we examined in Model 4 the combined effects of social and environmental performance and in Model 5 we've added the local firm and developing market MNC variable. The interactions with the IQI were mean-centered in order to avoid multicollinearity issues.

Table 4 goes about here

With respect to social performance, Model 2 shows that social performance is significantly related to financial performance (β = 0.31; $p < 0.01$). This result supports hypotheses 1a and indicates a significant positive relationship between social performance and financial performance at the BoP. When we examine in Model 2 the interaction term of social performance with the IQI, we find that the interaction term is positive and significant (β = 0.14, $p < 0.05$) which supports hypothesis 2a. Finally, in the full Model 4 the relationships for social performance and the interaction term with IQI remains stable and significant. These results indicate that social performance is positively related to financial performance and that at higher levels of IQI the effect of social performance is significantly larger compared to lower levels of IQI. These results therefore provide strong support both hypothesis 1a and 2a. To ease interpretation we plotted the moderating relationship in Figure 1 for a low IQI (-1.5SD) and for a high IQI (+1.5SD). The results show that the impact of social performance is positive but small in a low IQI environment and that the effect of social performance on financial performance is substantial in a high IQI environment at the BoP.

Figure 1 goes about here

When we take into account the explanatory power of the model, adding social performance and the interaction term of social performance with the IQI adds more than 4 percent of explained variance to the model, which is a significant increase of explained variance ($p < 0.01$). This result supports the contingent role of institutional quality on the relationship between social performance and financial performance at the BoP. It indicates that the positive relationship (Hypothesis 1a) applies particularly to a specific condition of firms that operate in a high IQI environment. At low levels of IQI, firms have a smaller profit incentive to increase their social performance.

In Model 3 we examine environmental performance and the interaction terms with the IQI. Adding environmental performance to the basic model did not increase the explained variance. Our findings therefore suggest that environmental performance is not an important explanatory variable of financial performance at the BoP. The results also do not support the contingent role of the institutional environment as proposed in hypothesis 2b. On the contrary, even though the coefficients are not significant they are negative rather than positive for environmental performance at the BoP. Social and environmental performance may partly overlap, so variance explained by environmental performance may also reflect variance explained by social performance. Therefore, in Model 4, we estimate both relationships and the interactions simultaneously and find that the results do not change substantially when combining the relationships of social and environmental performance simultaneously in a single model.

In Model 5 we added the local firm variable and the developing market MNC variable to the model. We find that in line with hypothesis 3a and 3b that local firms have a lower performance than multinational firms while firms from developed markets indeed have lower performance than multinationals from developing markets at the BoP. Model 5 shows that local firms have significantly lower performance ($\beta = -0.57$; $p < 0.05$), and that firms from developing countries have significantly higher performance at the BoP ($\beta = 0.64$; $p < 0.01$). Also, adding these 2 variables to the model increased the variance explained by more than 5%. Finally, we conducted several sensitivity analyses for our results by estimating the model using different sets of items of social value and environmental value. The results did not significantly change with these changes, further increasing our confidence in the robustness of our results.

In sum, the evidence indicates that the relationship of social performance is important at the BoP and that its relationship with financial performance is moderated by the quality of the institutional environment. Also firms familiar with the low income markets and firms with superior capacity have higher financial performance at the BoP. These results indicate that the “doing well by doing good” proposition is in line with the logic of the contingent resource-based view sensitive to the quality of the institutional environment and capacity of the firm.

We should consider the study's limitations in drawing conclusions from the empirical results. First, an important part of our data was comprised of self-reported assessments of senior managers (or directors/owners). Although we took several steps both in the design and testing phases to limit concerns regarding single-informant data, we cannot completely rule out issues of single informant bias in the results with respect to hypotheses 1. However, a strong inter-rater agreement and inter-rater reliability, along with the confidentiality that was assured for respondents, reduces our concern that responses were biased. Furthermore, with respect to hypotheses 2 we use different sources and problems related to single informant data do not apply to this relationship.

Second, the data employed in this study was cross-sectional. Further longitudinal research is needed to empirically explore the impact of different time horizons on the performance relationships at the BoP (Brammer & Millington, 2008).

Third, the representativeness of the sample is slightly biased towards energy and housing activities. We do not know what the impact of this bias is on the results. However, we took several steps to limit concerns regarding sample representativeness. Most importantly, the large number of organizations that provided the contact details and their diversity in focus, type, and origin provide assurance that the sample is representative of firms operating at the BoP. We also tested for non-response bias and found no reason for concern. Nevertheless, given the chosen sample methodology there likely is a bias in that firms with very low levels of social and/or environmental performance, such as sweatshops, whose business models are targeted at exploiting the poor for profit, are not included in the sample. This may explain for example why we did not find a negative relationship between social and financial performance in low IQI environments in Figure 1. Given the method applied it is unlikely that we included firms with a very low social performance. Further research is needed to explore this relationship. Collecting data of these firms may raise challenging practical and ethical issues and is unlikely to be successful without the cooperation of local government authorities.

Fourth, we used perceptual measures for social and environmental performance. We examined the reliability of the perceptual measures of social and environmental performance and found satisfactorily inter-rater agreement of these measures across different respondents. Managers may be well positioned to assess the direct relationships of their businesses on social and environmental performance. On the other hand, it would be very difficult for community members that are not directly involved in the business to discern the relationships of one firm from other social and environmental influences. However, although we base our results on measurements of perceptions rather than real social and environmental performance, this is actually what may be important for real decision-making of managers at the BoP.

DISCUSSION AND CONCLUSION

In this paper, we set out to theoretically explore and empirically test the contingent effect of the institutional environment on the fundamental proposition of the BoP literature that firms can profit by creating social and environmental value, thereby simultaneously helping the poor and enhancing firms' financial performance. By theoretically specifying and empirically testing contingencies for inclusive strategies at the BoP, our research aims to inform the underlying management theory on important institutional conditions of poverty on the social/environmental performance and financial performance relationship. Our results do not support the assumption, common in the BoP literature, that social performance and environmental performance unconditionally relate positively to financial performance at the BoP. Instead, we found convincing evidence for a positive effect of social performance and moderating effect of the quality of the institutional environment where under conditions of relatively high institutional quality social performance positively relate to financial performance. However, environmental performance proved to be an insignificant factor at the BoP, regardless of the institutional conditions.

These results reveal that the generally held assumption in the BoP literature that firms can "do well by doing good" at the BoP is subject to particular conditions. On the one hand, our results show that it makes sense for governments to improve social norms not only for the sake of people at the BOP but that this can actually be financially beneficial for firms doing good for the poor. On the other hand, our results show that governments need to double down on environmental standards as these are not in companies' financial interests. As environmental performance is currently not positively linked to financial performance, even in better institutional environments, governments will have a tougher time convincing firms to implement better environmental behaviour.

As such our research shows that it is critical to develop institutional mechanisms at the BoP that create conditions for firms to incur the costs of their low social and especially environmental performance. Developing regulatory frameworks and effective monitoring and enforcement capabilities may improve the institutional mechanisms for imposing social and environmental costs on firms. NGOs and other civil society groups may also have a particularly important role to play in critically monitoring BoP firms' compliance with social and environmental regulations. Governments may not always have the capacity to monitor the private sector effectively (North, 1990; Wright et al., 2005). The private sector may also develop self-regulation, particularly because social and environmental responsibility of firms has assumed an increasingly central role on the managerial agenda.

Institutions at the BoP are generally developed differently and are of different importance than those at the top-of-the-pyramid. Generally, social institutions (Sharp, Agnitsch, Ryan, & Flora, 2002) are more important (London & Hart, 2004) and informal institutions are stronger (de Soto, 2000) at the BoP. Expertise and business skills may be unavailable and market-based ecosystems are generally underdeveloped (cf. Prahalad, 2005). In an environment underdeveloped in its institutions, companies have to "take responsibility for a wide range of functions in order to do business effectively" (Khanna & Palepu, 1997, p. 41). However, this requires substantial investments in infrastructure of which the financial returns are uncertain and subject to free-ridership of other investors at the BoP. Therefore, governments that would like to stimulate inclusive strategies by firms would be advised to develop absent or for the poor inaccessible institutions in order to allow business to generate positive financial returns from social and environmental performance. For example, governments may reduce corruption and provide training or education, implement monitoring systems and access to information, develop legal systems and judicial capacity, develop the healthcare system, and put in place an infrastructure that facilitates institutions to function efficiently. Furthermore, governments could improve the educational standards and training system, set social and environmental standards, develop business support groups, develop civic society, and develop the capacity amongst businesses to govern transactions. In addition to institutional quality development, governments can support existing local or foreign NGOs instead of viewing NGOs in terms of competing institutional powers (London and Hart, 2004). In fact, non-traditional institutional partners -such as non-profit organizations, community groups, civil society groups, and actors from the informal economy- may have the local knowledge, embeddedness, infrastructure, and network that are needed to develop an effective institutional structure at the BoP (e.g., Chesbrough et al., 2006).

Firms with inclusive strategies may also decide to take collective action and take initiative to contribute to the development of the institutional environment. Our results indicate that improving the institutional quality can be in the strategic interest of these firms. Mair and Martí (2006, p. 40) argue that the ability to change norms that comes from firms filling institutional voids (e.g., money cannot be loaned without collateral, much less to the poor) may turn out to be even more significant than the initial problems that these firms set out to address. Examples include better healthcare within a community, leveraging existing local institutions resulting in jobs for the local community, increased access to information for the local community, strengthened local support groups, improved monitoring and enforcement of environmental standards, etc.

Thus, the necessary investments in institutional development at the BoP go hand in hand with social and environmental value creation but may require the political will of the government to allocate significant priority to institutional development. These government investments will reduce

the incentives for firms to exploit the poor and pollute the environment, rather than investing in social and environmental performance. The enhancement of the institutional environment will encourage firms to invest in social and environmental value, which (partly) further reduces the institutional voids at the BoP. Thus at the BoP, the developed social and environmental value itself also form an institutional basis that creates an enabling environment for a higher impact of social and environmental value creation on financial performance. Therefore, institutional investment from the government may create a virtuous cycle: the more governments improve the institutional environment the more companies may increase their social and environmental performance, and the more firms are likely to increase institutional quality at the BoP.

In a similar vein, the results show that foreign companies can have a keen interest in BoP markets given that they seem to significantly outperform local initiatives in doing well by doing good. Given that multinationals not only have more advanced capacity but that the lack of adequate infrastructure in BoP markets provides the proper environment to develop sustainable innovation, they are at a clear advantage over local companies. The results provide support for the key assumption of the base-of-the-pyramid proposition that foreign firms may usefully transfer their resources to the BoP market and therefore can reduce institutional voids and bring prosperity to the poor while at the same time gaining access to a large and profitable market. However, our results also qualify this conclusion given that the empirical analysis shows that foreign companies from emerging markets outperform multinationals from advanced countries. Foreign firms coming from other developing countries may have institutional advantages making resources and capabilities more tailored to local markets and institutions at the BoP. In fact, multinationals from developed markets will have to put in more effort to overcome their liability of high-income markets origin and truly get to know the poor and the poor's market and how to deal with institutional voids of their living environments in order to develop successful BoP strategies. However, firms active at the BoP that have their origin in developing markets may have the advantage of a multinational company but also have business models that are more aligned with the institutional environment and needs of the poor at the BoP.

In conclusion, our findings indicate that inclusive markets—i.e., a private sector that includes the poor both as producers and consumers and offers products, services, and opportunities for entrepreneurship—can be built and living conditions can be enhanced through the private sector's profit motive and through direct engagement with the poor (rather than depending on a trickle-down effect from economic development at the middle or top of the pyramid) conditional on the quality of the institutional environment at the BoP. In a relatively higher quality institutional environment, addressing social and environmental issues is not merely adjacent but actually central to strategy at the BoP. Integrating social and environmental value could, for example, enhance a firm's

embeddedness in local communities, thereby augmenting the firm's ability to co-discover and co-create new business opportunities and business models with local stakeholders from low-income communities (Hart, 2005; Hitt et al., 2005). However, this requires companies to develop the quality of institutions at the BoP in partnership with government institutions and NGO's. Such an institutional partnership strategy is thus central to a successful and sustainable strategy at the BoP. To help the private sector to be socially and environmentally sustainable at the BoP, the existing profit motive could be accompanied by innovative institutional arrangements targeted at doing business at the BoP in a socially and environmentally responsible way. These additional institutional arrangements can be developed at the micro level of the private organization and at the meso- and macro-levels by government organizations and NGOs to improve the access and quality of the baseline infrastructure and educate the poor on their role as stakeholders in their own economic development. Such programs could make the poor less vulnerable to exploitation and empower their position as stakeholders in economic development (as producers and consumers). Firms, and multinationals in particular, can play a critical role in these initiatives. For example, firms can organize BoP producers and thereby improve their bargaining power, they can empower people by treating them as transaction equals, provide the poor with more options, introduce bridging practices (Letelier et al., 2003), provide access to information, improve the skills of the poor, etc.

Firms operating at low levels of social and environmental performance will have different business models than those operating at high levels. Firms operating at low levels of social and environmental performance are more likely to have business models that focus on exploitation of cheap labor, poor working conditions, wasteful use of natural resources and minimal environmental controls. They minimize the costs of social and environmental performance through, for example, relatively cheap "feel good" social and "green washing" campaigns. On the other hand, business models operating at high levels of social and environmental performance thrive through strategies that develop the baseline institutional infrastructure and local capacity at the BoP, and leverage the associated benefits of high social and environmental performance through, for example, higher productivity, a creative workforce and positive relationships with local communities, while at the same time minimizing the associated costs (e.g., relatively low labor costs due to the workforce's high intrinsic motivation to contribute to a good cause, involvement of community members to take certain activities upon them, low environmental clean-up costs). Given the complexity of changing existing business models because of the inertia of specialized resources (Leonard-Barton, 1992) and co-evolutionary lock-in (Burgelman, 2002), firms specialized in a particular resource advantage are reluctant to change their specialized business model. In fact, they are much more likely to promote institutional conditions that favor their existing business model. Therefore, the decision of governments to develop a high quality

institutional framework may be of critical importance to encourage inclusive strategies. The need for such policies may be particularly important for countries that show high growth as several studies show that the high economic growth in emerging economies in recent years also were combined with lower environmental performance (Yale University, 2013) and higher rates of inequality (OECD, 2011).

This study demonstrated that in the context of the BoP, inclusive strategies can be motivated by self-interested profit maximizing behavior, however, that the effectiveness of this mechanism may be limited for environmental concerns and also depends on the quality of the institutional environment. As such this study contributed to the BoP literature but also to a broader debate in the economics and management literature on the role of the private sector's self-interested profit motive and its contribution to society (Mandeville, 1714). The findings of this study emphasize the role of public institutions in the proper functioning of the market mechanism and its benefits to society. Our findings apply to the context of the BoP and poverty alleviation but we hope this study may also inspire scholarly research in other areas of management where self-interested behavior of firms needs to be aligned with the generation of public benefits for society as a whole.

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Table 1. Items for social, environmental and financial performance

Social and environmental impact[a]

Here we ask your perception of the social and environmental impact of your organization on the communities in which it operates. Impact may be direct or indirect—i.e., the *direct impact* of your organization's operations and the *indirect impact* through other actors. The questions only refer to the *impact*, not the policies underlying these impacts. In addition, we are only interested in the impact of your organization's *core business*, not the impact of philanthropic activities. Please indicate the degree to which your organization has a positive or negative impact *on the communities* in which it operates within the areas below.

Social performance

Employment and income

1. Impact on overall employment
2. Impact on overall skill level
3. Impact on livable wages
4. Impact on local entrepreneurship

Safety and security

5. Impact on physical safety
6. Impact on resistance to natural disasters and climate change (e.g., hurricanes, earthquakes, floods, and the longer-term impact of climate change)

Governance

7. Impact on the availability of clear and correct information from government agencies
8. Impact on the integrity of the legal system within the community
9. Impact on participation of people in political decision-making

Quality of life

10. Impact on the infrastructure (housing, transportation, communication)
11. Impact on the availability of primary life necessities (water, air, sanitation, utilities, nutrition, clothing, etc.)
12. Impact on discrimination (e.g., in salary or gender)
13. Impact on human rights (respect for the dignity and worth of all human beings and freedom from fear and want)

Public services

14. Impact on the availability of qualitatively good (regular) education
15. Impact on health education
16. Impact on the availability of qualitatively good healthcare services and products

Environmental performance	*Health of the environmental systems* 1. Impact on the health of the terrestrial ecosystem, including its biodiversity 2. Impact on the health of the aquatic and marine ecosystem, including its biodiversity 3. Impact on air quality *Environmental stresses* 4. Impact on the amount of overall material use 5. Impact on the amount of water use 6. Impact on the amount of energy use within the value chain, including customers 7. Impact on the use of sustainable and renewable energy sources 8. Impact on the amount of toxic discharges to the environment 9. Impact on population pressure 10. Impact on natural resource management (e.g., productivity overfishing; percentage of total forest area certified for sustainable management)

Financial performance[b]

Please rank your organization's performance compared to similar organizations in your industry using the criteria below. Answer irrespective of the degree of importance you attach to each performance criterion

1. Sales growth
2. Customer satisfaction
3. Return on capital employed
4. Profitability and return on investment
5. Financial stability
6. Future prospects
7. Overall performance

[a] All items are measured on a seven-point scale ranging from 1 "large negative impact" to 7 "large positive impact". All levels of the scale had a description.
[b] All items are measured on a seven-point scale ranging from 1 "very poor" to 7 "outstanding". All levels of the scale had a description.

Table 2. Sample description[a]

Industry		*Number of employees*	
Trading/wholesale	15	10–25	72
Retail	10	26–50	25
Manufacture/repair	27	51–100	14
Farming/fishing/forestry	14	101–500	16
Building/construction	5	>500	16
Healthcare and social assistance	8		
Educational services	7	*Age of the organization (years)*	
Financial services	16	≤2	21
Business services	7	3–5	27
Power generation	7	6–10	36
Information	6	11–15	21
Other	21	16–20	10
		21–25	7
Type of organization		26–30	4
Free-standing enterprise	67	>30	17
Division / line of business of a larger firm	10		
Enterprise owned by a large holding company	12	*Location[b]*	
Partnership/cooperation	27	Sub-Saharan Africa	99
(Part of) a foundation (that is self-sufficient)	11	Europe and Central Asia	18
Other	16	East Asia and The Pacific	27
		South Asia	26
		Middle East and North Africa	17
		Latin America and Caribbean	38

[a] Sample size = 143.

[b] Firms can be active in multiple locations.

Table 3. Means, standard deviations, and correlations[a]

Variable	Mean	SD	1	2	3	4	5	6	7	8	9	10	11	12
1. Financial performance	4.92	1.12	1											
2. Social performance	5.15	.63	.18 *	1										
3. Environmental performance	4.46	.78	.05	.41 *	1									
4. Institutional Quality Index	3.66	.41	-.06	.23 *	.03	1								
5. Services	.28	.45	.10	.14	-.00	-.07	1							
6. Trade	.18	.38	.04	.01	.09	.09	-.29*	1						
7. Manufacturing	.19	.39	-.05	-.19 *	-.21 *	-.05	-.30*	.-22 *	1					
8. Firm size	3.62	2.63	.29 **	.19 *	-.12	-.01	-.06 *	-.08 *	.06	1				
9. Dynamism	4.59	1.18	-.03	.01	-.00	.06	.01	-.01	.00	.00	1			
10. Firm age	2.13	1.00	.27 **	.15	-.02 *	-.17*	.07	-.03	.04	.52*	-15	1		
11. Local firm	.53	.50	-.64	.05	.03	-.14	.06	-.06	.01	.06	.03	-.00	1	
12. Developing market firm	.66	.48	.27	.03	.06	-.11	.09	-.10	-.04	.00	.00	-.09	.76*	1

[a] N = 143. * Correlations are significant at $p < 0.05$.

Table 4. Results of the hierarchical regression analysis of social and environmental performance on financial performance

Variables	Model 1	Model 2	Model 3	Model 4	Model 5
Constant	3.60***	2.32*	3.60***	2.78*	2.56 *
Control variables					
Services	.12	.12	.12	.10	.10
Trade	.09	.07	.09	.03	.08
Manufacturing	-.29	-.22	-.29	-.24	-.20
Firm size (ln)	.33 *	.31 *	.33 *	.28 *	.29 *
Dynamism	-.01	-.01	-.01	-.01	-.01
Firm age	.29 ***	.25 *	.29 ***	.25 ***	.27 ***
Institutional Quality Index (IQI)	.12	.05	.12	-.05	-.05
Social performance (H1a)		.31 **	.	.34**	.34**
Social performance * IQI (H2a)		.14 *		.20 *	.17*
Environmental performance (H1b)			-.08	-.03	-.04
Environmental perf. * IQI (H2b)			-.03	-.12	-.10
Local firm (H3a)					-.57 *
Developing market MNC (H3b)					.64 **
R^2	.18 ***	.22***	.18 ***	.23***	.27***
ΔR^2 (Model 1)		.04 **	.00	.05**	.09 ***
ΔR^2 (Model 2)			-.04 *	.01	.05 *
ΔR^2 (Model 3)				.05 **	.09 ***
ΔR^2 (Model 4)					.04*
F-value	3.77***	3.73***	2.97***	3.22***	3.25***

† if $p < 0.10$; * if $p < 0.05$; ** if $p < 0.01$ *** if $p < 0.001$

[a] N = 143
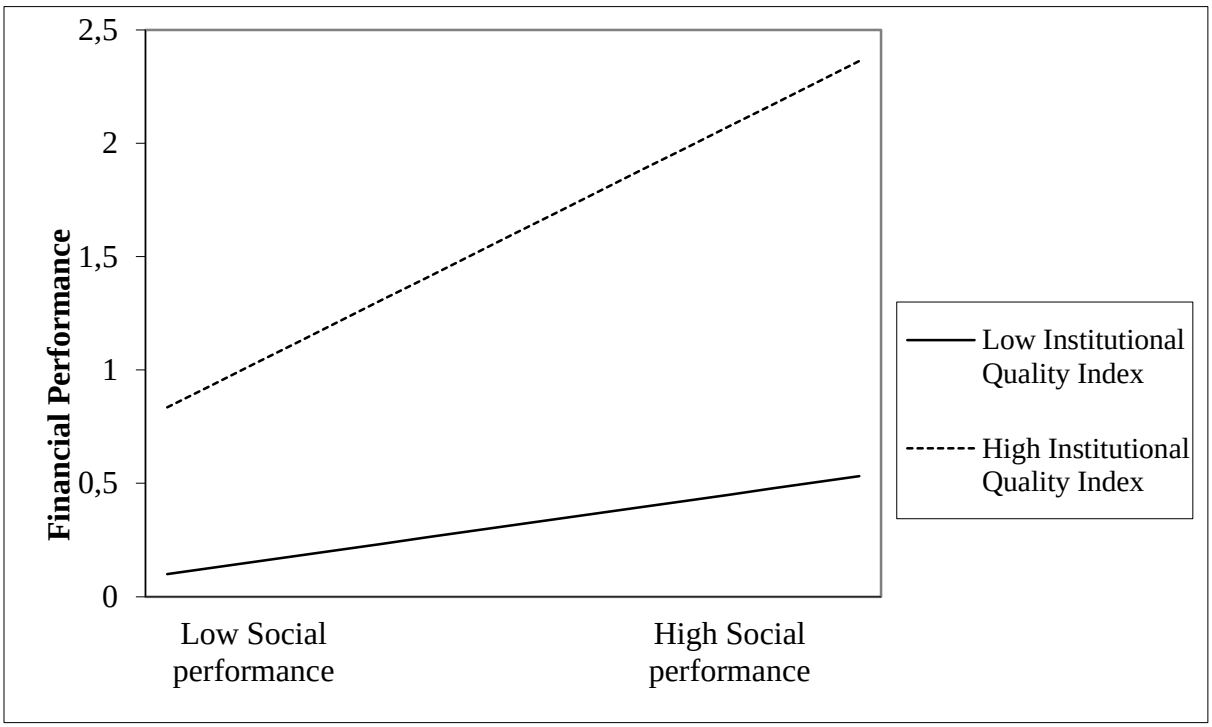
Figure 1. The relationship between social performance and financial performance in a low and high institutional quality environment