Sustainable Development and Sustainability of Competitive Advantage:
A Dynamic and Sustainable View of the Firm

Miguel A. Rodriguez, Joan E. Ricart and Pablo Sanchez

Abstract

Does the need for sustainable development hinder businesses’ ability to create value? Is firm’s competitiveness negatively affected by considering that need? After quickly reviewing the main literature contributions on the relationship between business and society, and drawing from resource-based view of the firm and sustainable development literature, this paper presents a proposal for a dynamic and sustainable view of the firm. It shows how considering the changes introduced into the competitive landscape by sustainable development influences the way in which companies develop their resources, capabilities and activities, fostering the persistence of competitive advantages based on knowledge and innovation.

Introduction: views of the relationship between the firm and society

The relationship between businesses and society has been extensively treated in management literature. From the efficiency view, the social responsibility of businesses is to increase their profits (Friedman, 70) with no other limits than those established by law and common decency (Sternberg, 99, working paper; Jensen, 01). There are other strands of literature that consider that there is or should be a closer relationship between businesses and society. The most important of these refer to corporate social responsibility (CSR1), which basically states why corporations should be socially responsible or not; corporate social responsiveness (CSR2), the purpose of which is to describe firms’ responses to social demands; corporate social performance (CSP), which started as a way to embrace the main contributions of CSR1 and CSR2 and later focused on the outcome of corporate behavior; and stakeholder theory (ST), the aim of which is to determine to whom firms are responsible and how and why companies should manage their relationships with them.

As figure 1 shows, all the above theories take one or more of the following approaches: the normative approach states what firms should or should not do; the descriptive approach explores what firms in fact do; and, finally, the instrumental approach posits that companies will obtain specific outcomes if they adopt specific behaviors. There have also been fruitful attempts to blend these approaches into what we have called an integrative approach.

Considering that the sustainable development concept involves economic, social and environmental factors (Gladwin et al., 95), and how the dynamic view of the firm (Ghemawat, 99) explains the sustainability of competitive advantages, the theory developed in this paper nicely fits into what could be labeled a dynamic and sustainable view of the firm. Before introducing our proposal of a dynamic and sustainable view of
the firm, we will briefly review the main features of these two views of the firm in relation to this proposal.

The dynamic view of the firm

It is well known that the purpose of all business strategies is to reveal how a business can persistently create more value. Achieving this goal largely depends on industry attractiveness and individual business positioning. A successful business position will, moreover, depend on the persistence of its supporting competitive advantages.

Business management literature has analyzed the persistence of competitive advantages mainly based on two theories: the resource-based business theory (Wernerfelt, 84; Barney, 91) and the activity-based business theory (Andrews, 71; Porter, 96). In general lines, the former emphasizes the resources and capabilities generated by the business and the latter, business activities themselves. Both lines of thought have been successfully inter-related beneath the value creation umbrella in the dynamic business view theory (Ghemawat, 99). As shown in graph form on figure 2, resources, capabilities and activities enable the creation of persistent competitive advantages in so much as they are difficult to imitate and substitute by current or potential competitors.

INSERT FIGURE 2 HERE
Figure 2. The dynamic view of the firm and the sustainability of competitive advantages
(adapted from Ghemawat, 99)

As we will explain later, accepting the responsibilities associated to sustainable development furthers the persistence of competitive advantages.

The sustainable view of the firm

The sustainable view of the firm is based on the need for companies to fully accept the fact that the business world is part of the natural (Shrivastava, 94) and social (Eells and Walton, 61; Davis and Blomstrom, 66) system; this fact has two dramatic implications for the corporate world: acceptance of the scarcity of natural resources (Hart, 95) and the notion of business and society’s co-responsibility related to the use and development of social resources (Eells, 60; Frederick, 87).

INSERT FIGURE 3 HERE
Figure 3. The four pillars of the sustainable firm

The sustainable view of the firm is based on four pillars (see figure 3). All of them relate to each other and support the idea that firms should create sustainable value (that is to say, economic, social and environmental value) in the double sense of the word sustainable: in a persistent way and coherently with the principles of sustainable development. Also, the normative and instrumental approaches co-exist in them all.
Physical reasons

Up to the middle of the 20th Century, industry and trade were able to grow as if there were no natural constraints. This was possible because the global consequences of these activities on the planet were quite limited, or even negligible. The magnitude of the pollution and use of natural resources derived from industry and trade was not sufficient to represent a threat to the biosphere.

In the last few decades, the physical limits of our planet, both as a provider of resources and as a sink for waste disposal, have been well established in theories, studies or concepts such as ecosystems biodiversity (Constanza et al, 92; Gladwin, 93; Hawken, 93), carrying capacity (Daly and Cobb, 89), the limits to growth (Meadows et al., 72; Meadows et al, 92) or ecological footprint (Wackernagel and Rees, 96). According to a systems approach to strategy, companies must broaden the environment that they take into account, including our natural environment.

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<th>Physical reasons</th>
<th>Examples</th>
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<td><strong>Normative approach</strong></td>
<td>Firms should consider this reality in order not to threaten the survival and development of present and future forms of life (Shrivastava, 94).</td>
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<td><strong>Instrumental approach</strong></td>
<td>Companies should consider this reality because natural constraints are bound to be one of the most important drivers of new strategic resources and capabilities (Hart, 95).</td>
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Social reasons

In the past, the social role of corporations was practically limited to creating employment, paying taxes and operating within legal limits. And indeed, for some scholars this is still the case. In any case, this was possible when firms’ playing fields were clearly delimited and society, while entrusting the satisfaction of others’ needs to governments and other institutions, did not expect much more from businesses than fair conduct as providers of employment and products.

Nowadays, society’s expectations have changed. One of the primary reasons behind this change is the globalization process. This process has transferred power from society to businesses, and society is demanding a parallel increase in their social responsibilities. Also, more educated and well informed citizens tend to be more sophisticated and, as a result, more demanding with firms. As polls confirm both in first world (MORI, 2000) and less developed countries (Millenium Poll, 99), citizens are increasingly demanding that corporations play a more active social role and take this into consideration in their purchase or investment decisions. In any event, social pressures can be powerful enough to turn demands into laws. Therefore, the systems view of strategy involves a further broadening of firms’ environments to include society.
Social reasons

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Ethical reasons

Companies are systems the structure of which is fundamentally based on people and the relationships between them. From an ethical point of view, to be members of a company or any kind of organization should contribute to people’s overall betterment as individuals. And it is obvious that this is not possible if they have to abandon their personal values when at work. Therefore, if as citizens people are demanding an increase in companies’ social obligations, they should be allowed to behave accordingly as employees. In short, the enlargement of firms’ environments to include nature and society involves an increase in their ethical obligations.

Another important consideration from an ethical point of view is that the whole architecture of the western paradigm is based on the fundamental right for every human being to enjoy equal opportunities to run his or her life. However (UN Human Development Report, 01), one out of five human beings has to survive with under 1 dollar a day and has no access to potable water; more than fifty per cent of the developing world lacks the most basic sanitation; one out of every six children receives no schooling; differences between rich and poor countries keep growing; per capita income in fifty countries is lower now than ten years ago; dozens of countries suffer endemic armed conflicts; democracy and respect for human rights are still the exception. Since the fundamental right to equal opportunities is still a wish, firms must help to make it come true.

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**Business reasons**

Business reasons are a result of physical, social and ethical reasons. If we again consider the three statements above representing an instrumental approach, we can easily agree on their business lineage. However, business reasons are not purely instrumental. If companies act correctly only because it pays off, it does not work. People and society look for coherence. And this is only possible when firms’ conduct is the result of profound beliefs and shared values among all their members. Therefore, business reasons are also normative. Or, better still, it is a perfect integration of the normative and instrumental approaches. This is the message at the core of this article: as we will explain in detail, considering the need to point towards a more sustainable development model deeply and positively affects the sustainability of firms’ competitive advantages.

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<td>Normative-instrumental approach</td>
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**A dynamic and sustainable view of the firm**

We will now examine how the development of resources, capabilities and activities, their possibilities of imitation or substitution and the persistence of competitive advantages, are influenced by the idea of sustainable development. Once we have been reminded of the changes introduced into the competitive landscape by sustainable development, we will analyze how sustainable development influences the dynamic view of companies, and therefore the way in which they develop their resources, capabilities and activities. We will then consider the impact of these changes on the strategic nature of resources, capabilities and activities and, therefore, on their possibilities of imitation and substitution. Finally, we will see how all this affects companies’ reputation and capacity for innovation, and consequently the possibility of them persistently creating value (see figure 4).

**A new firm landscape**

The speed and significance of technological changes and discontinuities has not come to represent the end of the industrial era, but its acceleration and growth (Senge and Carstedt, 01). To use the term post-industrial era implies, as proposed by sustainable development, fundamental changes referring to how the economic system affects and is related to the social and natural system in which it operates. In this respect, sustainable development introduces the notion of the scarcity of natural resources and the co-responsibility of companies and the societies in which they operate for the development and use of social resources.
Scarcity of natural resources

The industrial era began, developed and continues to operate based on the implicit idea that natural resources are of an unlimited nature. This has led the industrial system to be of a linear configuration, in which the basic elements follow a sequence consisting of extraction-manufacture-sale-use-disposal, generating waste at every step. This impact of this type of operation on the maintenance of natural assets was not severe as long as the level of development remained within certain limits. However, the acceleration and growth of the number of beneficiaries, plus the ethical need to benefit the world’s entire population, has clearly identified the intrinsically non-sustainable nature of this development model. In this respect, acknowledgement of the scarcity of natural resources and, therefore, the need to reduce the use of these resources and the waste generated by business activities, may be of primary significance for the development of new capabilities and activities, which could create persistent competitive advantages (Hart, 95).

Co-responsibility between businesses and society for the development of social resources

In practice, businesses operate independently from the social and natural systems that surround them. Sustainable development introduces the need to change this both in business operations in developed countries and, particularly, in under-developed and developing countries. There are two reasons for this: the increasing transfer of power, and therefore responsibility, from society to the business world, derived from the globalization process, and the possibility of creating economic value for shareholders.

Development of new resources, capabilities and activities

Companies have to develop new resources, capabilities and activities for the acceptance of the idea of the scarcity of natural resources and the co-responsibility between businesses and society for the development of social resources to give rise to persistent competitive advantages. Considering the specific characteristics and circumstances of each company, these resources, capabilities and activities will be the result of establishing new relationships with stakeholders. This is evidently nothing new (Freeman, 84; Jones, 95; Donaldson and Preston, 95). Indeed, firms have a large number of varied experiences in this field. What is proposed is that they take on new forms, based on new values and new content, so that they give rise to persistent competitive advantages. In any case, not all stakeholders or firms have the same characteristics. Therefore, although we will now provide a generic view of a sustainable business and its stakeholders, each company will need to develop its own.

Sustainable businesses and their stakeholders

The stakeholders who are more or less common to most companies are the following: shareholders and investors, public administration, customers, local communities, countries and societies, opinion leaders, employees, financial institutions, suppliers and sub-contractors, and strategic partners. As we mentioned earlier, the relations between firms and their stakeholders are evidently not all of the same kind. Depending on what they are like, and with no implications for the importance of each of
the stakeholders for companies, we can classify these relations as three main types or levels: the consubstantial level, the contractual level and the contextual level. By **consubstantial stakeholders** we mean the stakeholders that are essential for the business itself to exist. **Contractual stakeholders**, as their name implies, have some kind of formal contract with the business. Finally, **contextual stakeholders** play a fundamental role in obtaining business credibility and, ultimately, the acceptance of their activities (business license). They represent, moreover, the firm defense of common assets such as the environment, peace, safety, freedom and justice. Ultimately, of course, these relations will depend on the specific circumstances in each case. For example, in some situations, the relationship between a firm and its clients, or one client in particular, may be more consubstantial than contractual. In any case, we consider that this classification may be of help for companies that acknowledge the importance of improving how they manage their relationships with stakeholders. Initially, in spite of its generic nature, it provides an initial approximation and structured perspective of a certainly complex issue. Secondly, although each company has to build its own “relations map”, they are all likely to have relationships with stakeholders that could in one way or another be defined using these three labels: some are essential for the business itself to exist, others are the subject of primarily contractual relationships, and others will be the legitimate representatives of the social and natural systems in which the business operates. As we said earlier, this classification is not intended to introduce value judgements on their relative importance. Indeed, it is intended to emphasize the different nature of stakeholders and, therefore, the need for firms to establish the types of relationships that are most appropriate in each case. Figure 5 shows stakeholders classified according to the type of relationship in question. It can be clearly seen that, in addition to the bi-directional relationships between the firm and each stakeholder, there are also crossover relations between stakeholders that have to be taken into consideration by the business concerned.

**New relations with consubstantial stakeholders**

This section makes particular reference to employees. The image of a machine as the organizational paradigm of the industrial era has led to impressive productivity figures. However, this process has also involved the de-humanization of labor relations and generated, therefore, a general lack of interest on behalf of employees in their firms. Although as W. Edwards Deming said, “people are born with intrinsic motivation, self-esteem, dignity and curiosity to learn, joy in learning”, it is nevertheless a fact that employees are not a part of their companies. All they do is hire them part of their time. In the so-called information society, this situation has to change and man’s natural desire to learn has to be reinforced. For the learning culture to be a fact, and therefore for creativity and imagination in general to increase, most companies’ current control orientation has to be replaced by a culture based on trust and self-control (Senge and Carstedt, 01). As a large number of companies have discovered, considering the alignment with personal values involved, nothing is as powerful as sustainable development when it comes to attaining employee satisfaction and, consequently, commitment and global involvement (Senge and Carstedt, 01; Smith and Yanowitz, 98). The creation of a culture like this evidently requires, among other things, changes in
management style, structure, policies on the transparency of information, selection and payment systems, occupational safety, etc., and... time (Pfeffer and Veiga, 99; Mueller, 96; Olalla, 99; Greening and Turban, 00; Hillman and Keim, 01). But the results are well worth the effort (Huselid, 95; Pfeffer, 98).

New relations with contractual stakeholders

We specifically refer to clients, suppliers and sub-contractors. Traditionally, relations with them have been primarily of a competitive nature. Special emphasis has even been placed on the bargaining power of the different parts of the value creation chain (Porter, 85). In this respect, their capacity to demand value has been considered more important than their capacity to create, and therefore, deserve value. The new competitive landscape based on sustainable development implies that companies establish new relations with these stakeholders, in order to develop the products and services that the markets and society need, value and accept. These relations, for the same reasons as employee relations, should be based on trust instead of control. And emphasis will, moreover, be placed on the exchange of information, training, technologies, etc., in addition to long-term commitments. Although these relations may be formally of a contractual nature, the increasing lack of definition of where businesses end means that the most important, if not all, of them could ultimately be considered to be partners in the innovation process and in the creation and apprehension of value. These collaboratory relations, even considering that there will always be some degree of competitive tension, are fundamental in the corporate and business strategy of sustainable companies (Champy and Nohria, 96).

New relations with contextual stakeholders

Contextual stakeholders are the public administration, opinion leaders and creators of knowledge (the media, NGOs, universities, scientific community, etc.), and the communities, countries and societies where companies operate or on which they have an impact. The practical conviction that the business system is a part of the social and natural system has significant consequences on the characteristics of contextual stakeholder relations. It implies that business and society are not only independent, or merely inter-related, but that they are indeed interdependent (Chakravarthy, 86; Freeman and Evan, 90). It implies, therefore, that we must cease to consider that a company’s sole mission (and therefore its executives’ sole purpose) is to generate profit for shareholders. The mission of companies is, in fact, to identify opportunities that are beneficial both for itself and for society. In other words, since stakeholder relations are a vital source of diversity and involvement that provide businesses with a mission and valuable resources, managers have to cease to be mere shareholders’ agents to become builders of stakeholder relations (Kennelly, 95). They will then be more capable of rapidly and easily foreseeing, understanding and responding to changes in their environment (Porter and Stern, 01).
Strategic nature of the new resources, capabilities and activities

For resources, capabilities and activities to have strategic value and, therefore, give rise to persistent competitive advantages, they must comply with the following conditions (Barney, 91; Wernefelt, 84; Rumelt, 84): they have to be difficult to imitate by current competitors; they have to be difficult to substitute by current and new competitors; and they have to be valuable, i.e. positively valued on the market. We will now see how the resources, capabilities and activities the development of which depends on the previously defined stakeholder relations help us to comply with these conditions⁴.

Difficult to imitate

Certain capabilities related to subjects such as location, technologies, products or production processes may be difficult to imitate. Nevertheless, they are all subject to the possibility of being copied, or even acquired, by our competitors to some extent and at some time. However, resources, capabilities and activities that are socially complex, because a large number of individuals are involved in their development and maintenance, for which history and experience are important factors, in the sense that their present status depends on their earlier status, and which are of a tacit nature, characterized in that they can not be verbalized or formalized, are in practice inimitable. The proposed types of relations and their results comply perfectly with these premises. It can be said that they are difficult to imitate because they depend on a large number of people or teams and because they are intangible assets based on practical learning derived from experience and perfected with practice. Because of their socially complex and tacit nature, our competitors will be unable to obtain them by hiring our employees.

Difficult to substitute

All business models run the risk of being substituted sooner or later. Accepting the changes introduced by sustainable development on the competitive landscape and developing stakeholder relations does not totally protect companies against this risk, but it is considerably reduced. In the first place, because the information and know-how involved will be considerably and constantly more complete. Secondly, because most of the risk of substitution of resources, capabilities and activities will be increasingly related to the new implications derived from the need for more sustainable development.

Valuable

The resources, capabilities and activities proposed will be valuable if, in addition to distinguishing our business model from that of our competitors, they develop competitive advantages and increase their persistence. This partially depends on the evolution of society, and it is increasingly clear that society is advancing in its demands that business conduct should allow for more sustainable development⁵. Moreover, stakeholder relations like those described earlier may not guarantee, but certainly increase the probability that the innovations that directly or indirectly result from them are those needed by the market and society in general, and therefore be positively valued.
Sustainable development and innovation as a source of persistent competitive advantage

Acceptance of the changes in the competitive landscape derived from sustainable development and the development of the kind of resources, capabilities and activities defined above, primarily leads to the reinforcement of two clear sources of persistent competitive advantage: innovation and reputation. Both help us to establish a business model different from that of our competitors, and as we all know, this is a fundamental strategic element. They do, however, have radically different characteristics: reputation, since it is a scarce, valuable and inimitable resource, generates Ricardian rents, whereas innovation, since it implies the capacity to continuously develop new combinations of resources, produces Schumpeterian rents. Although reputation is therefore of undeniable importance, particularly if we consider that it is one of the reasons for the often enormous difference between the book and market value of businesses (Kotha et al, 01; Srivastava et al, 00; Black and Carnes, 00; Vergin and Qoronfleh, 98), we will focus on innovation, since it is a source of competitive advantage that generates value not only for the company but for society on the whole.

Innovation

Innovation, understood as the result of research and development (R&D&I) has become an essential condition for competitive success. In a discontinuous world, strategic innovation is the key to the creation of wealth. As Hamel (98) says, “Strategy innovation is the capacity to conceive the existing industrial model in ways that create new value for customers, foil competitors and produce new wealth for stakeholders”. In this respect, a great deal has been said and written (Edvinsson and Sullivan, 96; Riesenber, 98; Bouty, 00), and to a smaller extent applied, on the importance of intellectual assets as the input to R&D&I processes.

The challenges derived from the demands to advance towards sustainable development help companies to question usual ways of thinking and acting, and establish the need to develop new products, services and technologies. They are therefore a stimulant for organizational changes and an undeniable source of opportunities for innovation. Establishing new stakeholder relations leads firms to take hold of a wide range of current and future perspectives and visions of the world, to obtain information and knowledge of these opportunities, and to establish the collaborations required to make the most of them. Moreover, the process itself will help them to obtain the credibility required to attain social approval for their innovations.

Conclusions

As we have seen throughout this paper, the dynamic and sustainable firm is a knowledge based-knowledge creating company. The creation of this knowledge and its use as a revenue generator depend, among other things, on the following connected factors: the enlargement of the firm’s environment to include the physical and social
system; the broadening of the firm’s ethical obligations; and the establishment of new stakeholder relations based on open, smooth and honest dialogue. As a result of this, its ability to produce and obtain revenue in a persistent manner depends on and is inextricably entwined with its ability to produce social revenue.

Our proposal for a dynamic and sustainable firm is, clearly, a matter of governance. It implies fundamental changes in our understanding of corporate governance, and in the values and objectives towards which it must aim. Figure 6 is a graphic representation of these changes.

INSERT FIGURE 6 HERE

Figure 6. From traditional corporate governance to dynamic and sustainable firm governance

Since traditionally the core value guiding corporate governance has basically been of an economic nature, its goal has been to maximize stock value through investor satisfaction. In our proposal for a dynamic and sustainable firm, the core value is not economic growth but sustainable development. Because of this, the ultimate goal is to create value for firm shareholders and society as a whole in a persistent and sustainable fashion through stakeholder satisfaction and engagement. And this is only possible if firms not only do the right thing, but do so for the right reasons.
# FIGURES

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<tr>
<th>Approach</th>
<th>Normative</th>
<th>Descriptive</th>
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<td>Firm view</td>
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<td>Efficiency</td>
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Figure 1. Firms and society relationship views

Figure 2. The dynamic view of the firm and the persistence of competitive advantage (adapted from Ghemawat, 99)
Figure 3. The four pillars of the sustainable firm

Figure 4. A dynamic and sustainable view of the firm
Figure 5. The dynamic and sustainable firm and its stakeholders

Figure 6. From traditional corporate governance to the dynamic and sustainable firm governance

One basic article on this subject is by Prahalad, C.K. y S. Hart *The Fortune at the Bottom of the Pyramid*, *Strategy + Business* 26, 1-14.

See, for example, Pfeffer, J. and J. Veiga, *Putting People First for Organizational Success*, *Academy of Management Executive*, 1999, Vol. 13, No. 2.


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