Is best practice the best, indeed?

Lessons for business sustainability in transition countries

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Objectives

- Interpret developments in business sustainability in transition countries by the application of the theories of convergence and path dependence
- Analyze the specific characteristics of the determinants
- Draw consequences for future practice

Starting hypotheses

- Forces of convergence and path dependence are in constant conflict in transition countries
- After the transition to a new political-economic system, expectations were high that a new legal and institutional framework would promote sustainable development and convergence to best western practices
- Path dependence hinders the acceptence of western style best practices of business sustainability, yet it may result in local optima that could prevail for a long period of time
- Sustainability governance of business is a sub-case of corporate governance (CG) and the research on CG would provide valuable insights into sustainable business practices

Why convergence

- The failure of communism and the transition to market economy and pluralistic democracy has created an ‘in vivo’ laboratory for convergence
  - *Tabula rasa (clean slate)* concepts during the emergence of the new system (see environmentalism) and their errors
- Two major and reinforcing factors of convergence:
  - Privatization and creation of market system with its institutions – new playground for business
  - Accession to EU: legal harmonization
- Result: “Rule convergence”
- Note: Transition is a seemingly much more forceful case for convergence than more conventional interpretations of convergence towards a unified (mostly Anglo-Saxon) system of buiness governance or references to globalization as a driving force

Why path dependence

- Reality does not confirm expectations for convergence
- Even if there was rule convergence, there is no system convergence
- Question: Is there a realistic expectation for system convergence?
- Answer maybe found in the analysis of corporate governance practices

Business sustainability as a case of corporate governance

- The evolution of CG practices gives a unique insight into understanding the transition from communism to a market economy
- Institutions have major effect on economic, political and social progress. Understanding the particular institutional models will allow us to assess opportunities and constraints of development

General framework of business sustainability

- Legal framework
- Market structure
- Financial institutions
- Control and enforcement mechanisms
  - Incl. voluntary codes

Actual practice is defined as a function of all above

The transition: early 1990s

1. All of the CEE countries focused on passing state ownership to private ownership with no regard to who the new owners are. Corrupt processes favored “relationship capital” => resulting wealth accumulation is a distorted process: select few groups of players with disproportionate wealth and power
2. Recombinant property: creates distinct East European capitalism where no well defined boundary exists between the public and private sectors

…followed by inertia from late 1990s

- Recombinant property structures unsustainable => further privatizations eliminate state ownership
- Presence of multinationals strengthens
- Organizational differences between domestic and multinational companies become more visible
- Opaque processes surround evident need for central modernization projects
- **Sustainable development business strategies remain isolated affairs without national sustainable development strategy**

Management power in transition countries

Distinct groups of managers with different interest in SD exist along segmented ownership structures

- The privatization process allowed managerial elite to become owners of their firm
- Managers of multinational companies have little independence and are closely monitored by headquarters
- Managers of companies where ownership is still retained by the state are typically delegated by political parties and act accordingly

Convergence in CEE

Convergence:

- People of CEE tore down the Berlin Wall to gain political and economic freedom and increase quality of living => *converge* to West European standards
- Convergence of practices in developed countries towards Anglo-Saxon market oriented model to increase efficiency and competitiveness – may slow down due to financial crisis
- Globalization of capital and market power of institutional investors presents push towards uniform “best practices”

Convergence, general rules and best practices

- Why general rules?
  - Equal access, fair competition
  - Standards
- Do general rules define the “best” practice?
- “Best” practice: achieving aggregate welfare
  - Aggregate welfare and sustainability
  - Aggregate of cost-benefit analyses
  - Problem of measurement
  - Who defines the measures?
  - Whose costs and whose benefits in a fragmented society?

Limits to convergence in CEE

- “Imperfect” convergence in market institutions, capital markets and regulatory systems
- Imperfect and incomplete markets
- Emergence of local optima
  - Limited applicability of international “best practices”
  - Tenets of convergence (e.g. pressure to adopt most efficient development strategies in order to be internationally competitive) are not valid
  - Path dependence as resistance to “best” practice
  - Efficiency in a broader sense (switching costs are too high)

Path dependence in CEE

- Political and power arrangements as shown in previous slides
- Resistance to pressure to reach global optimum:
  - Global optimum is defined by non-local players
    - European Commission, WB, OECD
  - Insistence on reaching global optimum: American trained managers and lawyers, ex-pats; and TNCs
  - Interpreting the term ‘global’ raises uncertainties: defined under different conditions
    - interpretations maybe remote from local realities

Path dependence in CEE 2

Dual heritage creates the “path”

- Pre-WWII backwardness due to
  - late modernization (XIX century)
  - small countries historically characterized by strong ties between business and political elite
  - lack of original capital accumulation - destruction by WWI and WWII.
  - Model not sustainable
- Communist regime
  - Limited tolerance of private property
  - Double standards: don’t say as you do
  - Wasteful behaviour not punished
  - Model not sustainable

Conclusions 1.

- Path dependence makes only sub-optimal convergence in sustainable development practices possible
  - Sub-optimal solutions are normal consequences of unfavorable starting conditions
  - Achieving local optimum is still possible
    - “Rule convergence” and no systems convergence
- In Hungary not even local optimum could be achieved
  - Specific factors define additional limitations to convergence
  - Specific path dependence case

Conclusions 2.

Consequences for sustainability strategies:

- Lack of implemented national SD strategies hinders harmonization between private and public sector SD strategies and practices
- Adaptation of best business practices can result only in isolated and local (company) optimum
- Even local optimum is constrained by general unsustainable practices
- National sustainable development strategy needs to be developed in public-private discourse