



Operationalizing Norms, Material Incentives and Climate Action

Dr. David Belis
LINES – Faculty of Social Sciences
University of Leuven

Friday 9 September 2016



Operationalizing Norms, Material Incentives and Climate Action

1. Background Paper – “The Reinforcement Effect: How Climate Concerns Foster Competitiveness in the Global Economy”
 - Interaction effects between norms and incentives
 - U-shaped relationship between CFP and CEP
2. Operationalization: How to **measure/observe** norms, material incentives and climate action
3. Roundtable Methodology (Sarah Van Eynde)



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Background Paper – “The Reinforcement Effect: How Climate Concerns Foster Competitiveness in the Global Economy”

- What is a norm?
 - “Standard of appropriate behaviour for actors with a given identity” (Finnemore and Sikkink 1998: 891)
 - Logic of appropriateness: *where actors follow a rule or shared idea that is perceived as the “right thing to do”*
 - Examples:
 - Smoking in public places
 - Child labour
 - Drug abuse
- At this Roundtable: “genuine” climate concerns present within an organisation as a whole (e.g. company, government agency)

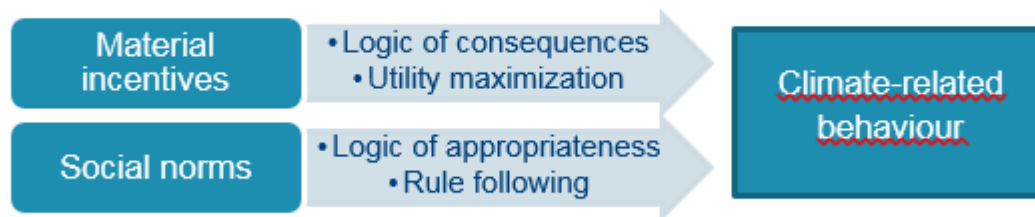


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Background Paper – “The Reinforcement Effect: How Climate Concerns Foster Competitiveness in the Global Economy”

- What are material incentives?
 - Tangible, material rewards for certain types of behaviour
 - Often associated with a logic of (expected) consequences (rational choice), where actors aim to **maximize utility**.
- At this Roundtable: companies are often perceived as purely “rational” actors. But observations show a **puzzling variation**

Figure 1. Traditional distinction between norms and material incentives

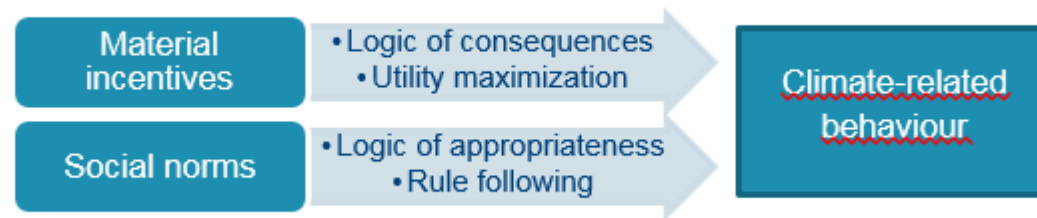


Source: author, based on e.g. Belis and Kerremans 2016; March and Olsen 1998; 2011; Fearon and Wendt 2002.

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Figure 1. Traditional distinction between norms and material incentives



Source: author, based on e.g. Belis and Kerremans 2016; March and Olsen 1998; 2011; Fearon and Wendt 2002.

- Beyond the dichotomy: interaction effects of norms and incentives
 1. Blinding effect
 2. Cognitive dissonance
 3. Reinforcement effect

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- **Blinding effect:** Norms trump material incentives
- When a company (or other organisation) is “blinded” by an overemphasis on the logic of appropriateness, creating negative impacts in terms of profitability
- Examples:
 - too optimistic expectations vis-à-vis customer uptake of green products
 - too costly or “wrong” investments in green equipment
 - Over-subsidization of solar panels
- Often create backlash in both economic and environmental ways (e.g. solar panel subsidies in Flanders)

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- **Cognitive dissonance effect:** material incentives trump norms
- When a company (or other organisation) is deliberately chooses a GHG-intensive investment with high short-term return on investment even when a viable climate-friendly alternative with a longer term IRR (internal rate of return) is available.
- Over time, the company may be forced (e.g. by its shareholders or because of reputational concerns) to reconsider this investment.
- Examples:
 - Extensive coal power development plans in several Asian countries (notably India)
 - Investments in oil exploration in the Arctic
- These investments are often turned back, leading to suboptimal economic and environmental outcomes (similar to the blinding effect)

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- **Reinforcement effect:** material incentives and norms are balanced
- Takes place when both logics are implemented coherently and reinforce each other.
- A logic of appropriateness could provide an extra “push” to invest time and resources in a company’s search for long-term solutions that improve both its business performance and its climate impacts.
- Iterative, mutually reinforcing process that could also involve the following elements:
 - Longer term cost savings (energy, waste reductions)
 - Attraction of a loyal segment of (new) customers
 - Stable and collaborative partnerships with other companies and organisations (e.g. joint transport solutions)

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- At the level of the employees / board of directors of the firm:
 - “Extra” motivation to find optimal solutions, both in terms of profitability and environmental performance, for example most efficient lighting, or most cutting-edge production equipment.
 - Collaboration between financial, technical and sustainability departments
 - Expected to thrive best in innovative, creative enterprises (e.g. Apple, Tesla,...)
 - **IMPORTANT LINK WITH INNOVATION**

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- **Reinforcement effect:** material incentives and norms are balanced
- **Example of Unilever:**
- about 50 percent of its growth in 2014 came from sustainable living brands, which also grew at twice the rate of the rest of the business
- “This sense of purpose and our USLP attracts and retains talent”
- But CEO Paul Polman, architect of Unilever’s SD strategy also warns against a “blinding effect”:
- *“imperative that the relationship between the ethical and the financial be understood as one of reciprocity and balance: just as the pursuit of financial capital should not be at the expense of the environment, businesses should not resort to excessive philanthropy” (Bell 2013: 39).*



Paul Polman, CEO of Unilever

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- **Reinforcement effect:** material incentives and norms are balanced
- Example of Triodos Bank:

Prestaties aandelenportefeuille Triodos versus MSCI

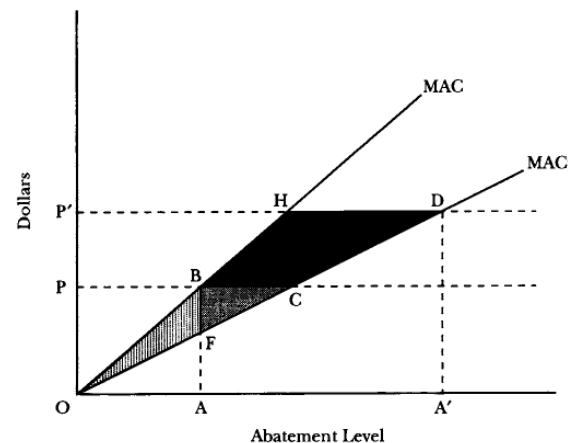
Start = 100 bij start Private Banking in september 2005



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- **U-shaped relationship between CFP and CEP (TLGT)**
- Too-little-of-a-good-thing effect
- First proposed by Trumpp and Guenther (2015)
- Background:
 - Conflicting hypotheses since 1970s: In 1970, Milton Friedman kicked off the debate by stating that the “social responsibility of business is to increase its profits” (Friedman 1970). This led to the formulation of the trade-off hypothesis, which says that taking the environment into account in company decision-making will adversely affect profitability.
 - End-of-pipe technologies



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- **U-shaped relationship between CFP and CEP (TLGT)**
- Hypotheses supporting a positive relationship:
 1. Porter hypothesis: innovation + first-mover advantages
 2. Natural Resource Based View: organizational capabilities + anticipation of future regulation
 3. Instrumental stakeholder theory: reputational advantages, including higher stock market values + increased business performance

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- **U-shaped relationship between CFP and CEP (TLGT)**
- Possible reconciliation of these conflicting hypotheses: U-shaped relationship
- “there is a negative CEP–CFP relationship for companies with low CEP and a positive association for high CEP”
(Trumpp and Guenther 2015)
- = Too little of a good thing (TLGT) effect
- Tested on 700 EU and US companies
- Companies employing a reactive strategy will tend to have more costs than benefits, while companies that pursue a proactive environmental strategy may have higher benefits than costs.

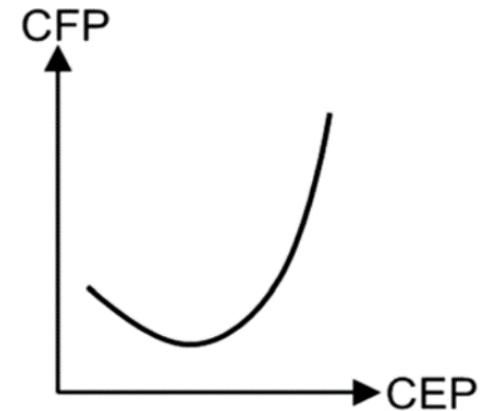


Figure 4. A U-shaped relationship between corporate environmental performance (CEP) and corporate financial performance (CFP). Source: adapted from Trumpp and Guenther (2015).

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- **U-shaped relationship between CFP and CEP (TLGT)**
- fits with the “three pillars” view of sustainable development, namely that economic prosperity depends on social and environmental protection and vice-versa. **Perhaps the sustainable development paradigm is just as true for a single company as it is for the entire planet**
- But also, and crucially, depends on the environment in which these companies operate
- More research is required to verify these claims!

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- **Link between reinforcement effect and U-shaped relationship between CFP and CEP (TLGT)**
- Not necessarily the case!
- TLGT effect can, in principle, be explained by a “rational” strategy, aimed at increasing business performance through all associated benefits
- However, best empirical examples show that some level of normative engagement seems to highly stimulate the employment of a **proactive environmental strategy**
- Perhaps linked to the credibility of such a strategy (both internal and external to the firm).

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Operationalization: How to measure/observe norms and material incentives for climate action

- How to measure/observe genuine normative concerns for climate change:
 1. ASK: how do firms communicate about climate change
 2. CHECK: what are the lobbying positions of firms (e.g. EC consultations on climate policies)
 3. LOOK: verify this with actual behaviour of the firm in terms of emission reductions
 4. THIRD OPINION: what do other, independent analysts think of the firm's actual attitude?

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Operationalization: How to measure/observe norms and material incentives for climate action

- How to measure/observe material incentives for climate change
- Conditional on wide number of variables:
 1. Carbon pricing
 2. Standard setting (e.g. EE for appliances, buildings, cars)
 3. Energy costs
 4. Customer preferences
 5. Supply chain influence
 6. Competitiveness of the sector
 7. Availability of cost-effective alternative products/production methods, e.g.:
 - Steel or cement production
 - Electric vehicles

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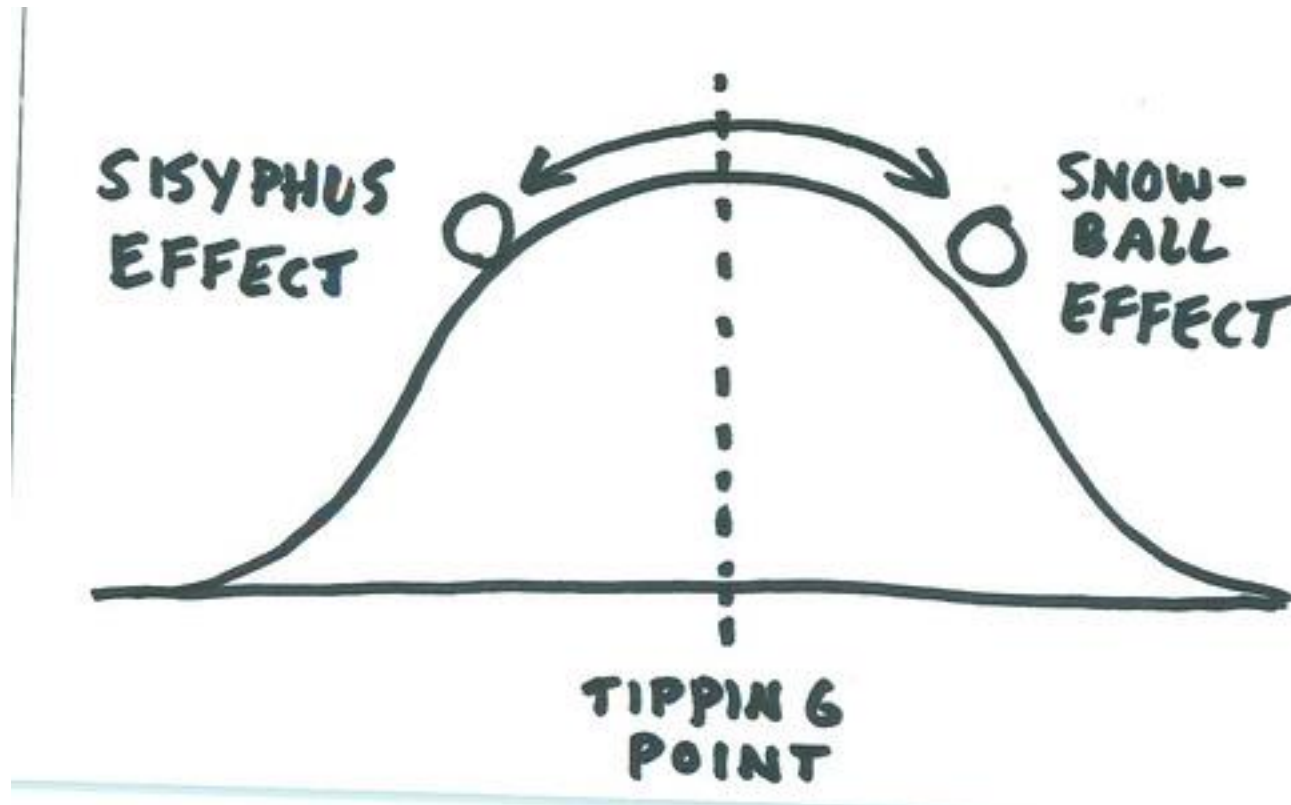
The effect of the Paris Agreement on Norms and Incentives for Climate Action

- **Paris Agreement**
- Major global relevance of the 2015 Paris Agreement
- Joint US-China ratification at G-20 summit in Hangzhou
- Major normative / material / policy “signal” to investors
- But implementation remains key!



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Are we at a Tipping Point for climate action?





Thank you!