

# Effective Corporate Environmental Strategies Are Rooted in Public Policy

BY THOMAS P. LYON

Lyon holds the Dow Chair of Sustainable Science, Technology and Commerce at the Stephen M. Ross School of Business. His research explores the interplay between business strategy and public policy and how it affects issues such as electric utility investment practices, natural gas contracting, innovation in the healthcare sector and the introduction of competition in regulated industries. Cambridge University Press published his new book, *Corporate Environmentalism and Public Policy*, in October. It is the first book to provide a rigorous analysis, rooted in economic theory, of voluntary approaches to environmental protection.

In recent years, companies have been increasingly likely to voluntarily adopt measures to reduce pollution — a development that contradicts conventional motives. Why, after all, would corporations willingly accept the increased costs that accompany environmental protection initiatives?

In most cases, it's because they are playing the public policy game.

Voluntary pollution abatement — a phenomenon called “corporate environmentalism” — can preempt the adoption of stricter government regulations, influence the shape environmental man-

dates take as they are developed and even deflect vigorous enforcement of existing laws. Savvy companies wield corporate environmentalism as an important part of their strategy.

Whether the strategy is successful, however, depends on whether it is built upon a solid understanding of the public policy life cycle. Without this insight, managers are left to devise and carry out corporate environmental policies without adequate focus.

## The Unfolding Public Policy Life Cycle

When it comes to chronic environmental problems, the public policy process typically follows a consistent course. Early on, the issue often is ignored or unnoticed for long periods before advocacy groups organize and mobilize. From there, public recognition gradually grows as scientists, activists and other opinion leaders debate the issue, assess its importance and discuss options for addressing it. It may take years, however, for demonstrations, news coverage, public discourse and scientific revelations to elevate awareness. Many times, it takes a dramatic event or a crisis to propel the problem past this stage and trigger widespread acknowledgement, concern and action.

In 1974, for example, scientists for the first time publicly contended there was a



MARTIN VLOET

Thomas P. Lyon

link between use of chlorofluorocarbons (CFCs) and depletion of the ozone layer over Antarctica. Some political reaction followed — CFCs were banned in aerosol sprays in 1978 — but chemical companies successfully resisted more stringent regulations. The issue remained largely dormant for a decade, until hard evidence emerged that proved CFCs were damaging the Earth's protective layer. This resulted in an intensified public outcry

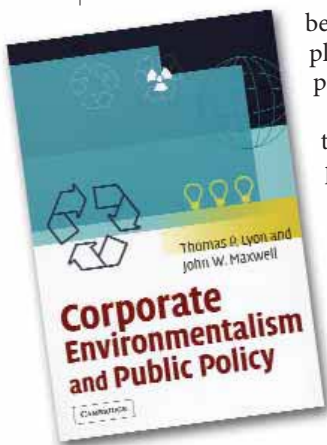
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and political response.

“When our country began to pass environmental laws in the early 1970s, we did it issue by issue, crisis by crisis,” Carol Browner, former administrator of the U.S. Environmental Protection Agency, said in a 1994 speech. “I will never forget a photograph of flames, fire, shooting right out of the water in downtown Cleveland. It was the summer of 1969 and the Cuyahoga River was burning. An angry nation was called to action, and the Clean Water Act was passed.” Browner went on to recite a litany of similar scenarios. After thousands of barrels of toxic chemicals were discovered



buried beneath the community of Love Canal, Congress passed the Superfund law. The image of farmers shooting their contaminated cows fueled public pressure, which culminated in passage of the Toxic Substances Control Act. Contamination of New Orleans' drinking water catalyzed pressure for the Safe Drinking Water Act.

For corporations, it's much more difficult to manage a public crisis than a gradual buildup in public discontent. At the same time, empirical research shows that U.S. financial markets reward firms that surpass legal requirements for the reduction of toxic emissions and punish firms that generate unexpectedly high levels of emissions. Voluntary environmental protection, then, makes good business sense under certain circumstances.

Governments of many nations, meanwhile, have embraced voluntary environmental programs. This approach reflects a belief that traditional regulatory measures can be costly, ineffective, politically infeasible and difficult to implement because their costs and benefits are unclear and sources of pollution are numerous and diverse.

To navigate this course effectively, to pinpoint the tradeoffs and tipping points, managers must know where the environmental issues linked to their companies reside on the public policy life cycle. They also must master the techniques for defusing these potentially volatile issues before they escalate and produce pressure for stringent regulatory controls.

## Strategic Preemptive Action

One of the most effective ways for an industry to deflect pollution-control mandates is to reduce pollution voluntarily. This type of self-regulation induces environmental groups not to organize on a particular issue and may preempt passage of new government mandates—which likely would be more stringent and onerous than the voluntary standards adopted by industry.

In the late 1980s and early 1990s, total emissions of 17 toxic chemicals declined markedly even as industrial productivity rose (see chart above). These environmental gains did not result from government regulation because the emissions were legal. The reductions occurred through voluntary action.

Research rooted in economic theory

(and described in detail in *Corporate Environmentalism and Public Policy*) found that states with high levels of toxic emissions and large membership in environmental groups produced more voluntary pollution abatement. In these states, the threat of mandatory regulation was high and the marginal cost of self-regulation was low, so voluntarily reducing emissions made good business sense. This underscores a key finding of the research: A legitimate threat of regulatory action often is required to induce companies to voluntarily surpass minimum regulatory requirements.

Environmental advocates, meanwhile, may accept self-regulation that achieves less pollution abatement than regulatory mandates would because they conserve political capital and other resources when a protracted public policy battle is avoided.

## Influencing Future Regulations

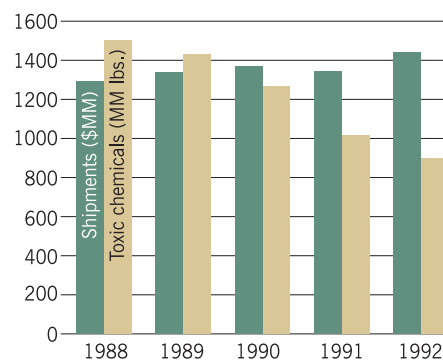
Even when legislation isn't derailed, it can be influenced through corporate environmentalism. This occurs in the next stage of the public policy life cycle—when regulatory agencies draft the rules and procedures that dictate how a new law will be enforced.

For example, a firm may voluntarily invest in pollution abatement and lock in a specific type of "green" technology, gambling that regulators will be unlikely to write rules that would force the firm to make a costly change. In this way, the company commits to a modest improvement in an effort to prevent the regulatory agency from imposing a tougher, more costly alternative.

Under another strategic approach, a company may invest in high-quality environmental controls before new minimum requirements are established—if it can do so at a lower cost than competitors due to superior technical or managerial skills. In this scenario, the goal is to convince regulators that this high level of pollution control is appropriate and affordable—so they will set standards that afford competing firms at a disadvantage.

In 1987, the Montreal Protocol was signed by a group of countries agreeing to reduce chlorofluorocarbon emissions by 50 percent by 1999. DuPont, the world's largest producer of CFCs, unexpectedly went a step further and announced plans to eliminate CFC production altogether.

## CORPORATE STRATEGY AND THE POLICY LIFE CYCLE



TOTAL EMISSIONS OF 17 TOXIC CHEMICALS VERSUS VALUE OF SHIPMENTS FROM SEVEN U.S. MANUFACTURING INDUSTRIES, 1988-1992

When the protocol was renegotiated three years later, the signers followed DuPont's lead and agreed to a full phase-out of CFCs.

This was precisely the outcome for which DuPont hoped. The company had invested heavily in an alternative to CFCs and was ahead of its competitors. By strategically maneuvering to have CFCs banned, DuPont forced the industry to shift from a mature market where it had low profit opportunities to a new market where it had a competitive advantage.

## Deflecting Enforcement of Existing Regulations

Corporations also voluntarily reduce pollution to demonstrate a commitment to exceeding environmental standards. The goal is to convince regulators the company is in compliance and trustworthy—so they will target their monitoring and enforcement efforts on firms with lesser reputations.

The EPA's StarTrack program acknowledges—and leverages—the value companies place on deflecting regulatory enforcement activities. Under this incentive program, firms that voluntarily increase their pollution controls are rewarded by being designated "a lower inspection priority."

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