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WHY DO FIRMS ADOPT 'BEYOND-COMPLIANCE' ENVIRONMENTAL POLICIES?

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This paper examines why firms *selectively* adopt 'beyond-compliance' environmental policies. It argues that existing explanations based on factors external to firms are under-specified and a focus on internal dynamics is also required. It draws insights from institutional theory, corporate social performance perspective, and stakeholder theory and relates them to internal processes. Beyond-compliance policies are adopted, if at all, due to two types of intra-firm process: power based and leadership based. These processes arise under different conditions and lead to different types of outcome. Copyright © 2001 John Wiley & Sons, Ltd and ERP Environment.

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INTRODUCTION

This paper examines why firms *selectively* adopt 'beyond-compliance' environmental policies – those more stringent than the requirements of extant laws.[1] It argues that the existing explanations based on factors external to firms are *under-specified* (not wrong) to answer this question. We *also* need to focus on dynamics internal to firms. Though factors external to firms create incentives and expectations for managers, intra-firm politics influences how managers perceive and interpret external pressures and act upon them.

It needs to be emphasized that there are established literatures on 'unpacking' firms (March and Simon, 1958; Cyert and March, 1963; Marris, 1964; Katz and Kahn, 1966; Thompson, 1973) as well as on the impact of external factors on intra-firm dynamics (Cyert and March, 1963; Pfeffer and Salancik, 1978; DiMaggio and Powell, 1983; Oliver, 1991). However, environmental policy and beyond-compliance literatures still treat firms predominantly as unitary actors, thereby ignoring their internal politics (notable exceptions include Fischer and Schot, 1993; Sinclair-Desgagne and Gabel, 1997; Reinhardt, 1999).

Beyond compliance is different from over-compliance. In the latter, firms seek to comply

[1] While acknowledging that two firms or two policies are seldom identical, selective adoption could be viewed to imply that a given firm adopts only some but not all policies with similar characteristics, or different firms within the same industry respond differently to a given policy.

with the law but, due to technological indivisibilities, deliver more than the legal requirement. Also, adopting uniform technologies across facilities that face varying environmental regulations results in over-compliance (Oates *et al.*, 1989). In contrast, beyond-compliance policies specifically intend to exceed the requirements of extant laws. They may involve modifying physical aspects of value-addition processes or adopting new management systems.

This paper focuses on the roles of key managers – policy-supporters – who champion beyond-compliance policies. The behavioural theory of the firm suggests that managers are 'boundedly rational', often have heterogeneous preferences, and are organized as coalitions that seek different policy objectives (Simon, 1957; Cyert and March, 1963; also Allison, 1971). Since boundedly rational managers make decisions under uncertainty, decision-making is often influenced by inter-managerial interactions. Employing these insights, this paper suggests that beyond-compliance policies provide political space for 'discursive struggles' (Hajer, 1995) within firms to debate the policies' long-term profit and non-profit impact. Clearly, the cognitive component of organizational decision-making is important because values, mental models, and 'sense-making' on beyond-compliance policies differ across managers (Hambrick and Mason, 1984; Daft *et al.*, 1988; Grant *et al.*, 1998).

Discursive struggles take place among three categories of managers: policy-supporters, policy-neutrals, and policy-sceptics. If such policies are adopted, it is by two kinds of process: (i) power based, where policy-supporters, in face of opposition from policy-sceptics, 'capture' the top management and have it mandate the adoption of such policies, and (ii) leadership based, where policy-supporters succeed in inducing consensus, convincing policy-sceptics and policy-neutrals of the long-term benefits of these policies.

Though in both power-based and leadership-based processes managers invoke the external environment, they do it in different ways to advocate their policy preferences. The final outcome depends on factors such as policy-supporters' hierarchical positions, their persuasive or canvassing abilities, their expertise in the issue area, and how they invoke external factors to shape perceptions of others. Policy outcomes would also be influenced by the degree of organizational change required for their implementation: the greater the predicted change, the stronger the incentives for the 'losers' to oppose policy adoption. Consequently, the likelihood of policy adoption decreases.

The contributions of this paper are fourfold. First, it highlights that efficiency-based theories are under-specified in explaining why firms selectively adopt beyond-compliance policies. Second, at a broad level, this paper argues that 'agents' have some (not complete) autonomy in pursuing beyond-compliance policies; external 'structures' alone cannot provide fully specified explanations (Child, 1972; Granovetter, 1985; Ostrom, 1990; Quinn, 1988; Wood, 1991; also see Holm, 1995). Factors internal to firms *also* need to be taken into account. Third, it integrates insights from institutional theory, stakeholder theory, and the corporate social performance perspective (that focus on pressures external to firms) with leadership-based and power-based theories of firms' internal dynamics. Finally, since the conclusions of this paper are generalizable to other issue areas where firms adopt beyond-compliance policies, it outlines important questions for future research.

This paper has four sections. The first proposes a typology of environmental policies. The second section first discusses the shortcomings of efficiency-based theories in explaining the research question. Then, it examines the existing literatures (corporate social performance, stakeholder theory, and institutional theory) that offer insights on why firms could adopt beyond-compliance policies. The third section conceptualizes dynamics internal to firms. Two broad approaches are presented: power based, and leadership based. The fourth section discusses the theoretical implications, areas of further research, and limitations of this paper.

CATEGORIES OF ENVIRONMENTAL POLICIES

The profit-maximizing view of the firm predicts that firms will adopt policies that can be demonstrated, *ex ante*, to meet or exceed firm's profit criteria. Of course, to test whether such criteria are met, policies will need to be evaluated by investment appraisal procedures. Thus, from a managerial perspective, environmental policies can be classified along two attributes: (i) whether their profitability can be evaluated by capital-budgeting or some other established investment appraisal procedure and they meet or exceed the *ex ante* profit criteria; (ii) whether they are required by law or they are beyond compliance. Based on these attributes, four policy types can be identified (see Table 1).

Type 1. Beyond compliance, profitability can be assessed through investment appraisal procedures, and meet/exceed the *ex ante* profit criteria.
Type 2. Beyond compliance, profitability cannot be assessed through investment appraisal procedures, therefore cannot be demonstrated to meet the *ex ante* profit criteria.
Type 3. Required by law, profitability can be assessed through investment appraisal procedures, and meet or exceed the *ex ante* profit criteria.
Type 4. Required by law, profitability cannot be assessed through investment appraisal procedures, and therefore cannot be demonstrated to meet the *ex ante* profit criteria.

Since type 3 and type 4 policies are required by law, firms are expected to adopt them. This is especially true for industrialized countries where environmental laws are perceived by managers as being strictly enforced and penalties for non-compliance significant. Consequently, it is not expected that most managers will support their firms systematically violating environmental laws.[2] This paper therefore does not focus on these policies.

Type 1 policies, though not required by law, are consistent with the profit-maximizing model of a firm since their profitability can be assessed by formal procedures and they meet the *ex ante* profit criteria. For example, scholars suggest that since pollution represents resource waste, firms can increase profits by voluntarily reducing pollution (Hart, 1995; Porter and van der Linde, 1995; Shrivastava, 1995; Russo and Fouts, 1997; Hart and Ahuja, 1997; for a critique see Walley and Whitehead,

[2] I am only referring to managerial *perceptions* that I observed in my fieldwork in the United States. These perceptions are perhaps puzzling because there has been non-attainment in some environmental statutes (Bagby *et al*., 1995). Recent data also suggests lax enforcement of key statutes. One-third of major air polluters in the US have not been inspected since 1997. In ten states, more than 40% of all Clean Water Act inspections were so-called 'reconnaissance inspections', in which inspectors were not required to get out of their cars (*Daily Grist*, 2000). One can hypothesize that if such lax monitoring continues, and/or non-attainment is not severely sanctioned, managerial perceptions, and consequently their disincentives for non-compliance, could change.

Table 1. Categories of environmental policies (Prakash A. 2000a. *Greening the Firm, the Politics of Corporate Environmentalism*. Cambridge University Press. Reproduced by permission of Cambridge University Press)

Compliance dimension Investment appraisal procedures and *ex ante* profit criteria	Ensure compliance	Result in going beyond compliance
Established procedures to assess profitability can be employed and the policy meets or exceeds the *ex ante* profit criteria	Type 3 profitable policies that are required by law and are implemented with low inter-manager conflict	Type 1 policies that involve profitable organizational changes with low inter-manager conflicts
Established procedures to assess profitability cannot be employed	Type 4 policies that are required by law and are implemented with low inter-manager conflict if there is stringent punishment for non-compliance and effective monitoring	Type 2 policies that involve inter-manager conflicts

1994; Newton and Harte, 1996). Such policies therefore enable firms to capture the 'low-hanging fruit.' It is also suggested that type 1 policies enable firms with greater consumer contact to compete on environmental quality and charge a premium (Arora and Cason, 1996). Based on these arguments, type 1 policies seem win–win for virtually every constituent. Of course, due to inertia or lack of knowledge about profit opportunities, firms may be slow to adopt them. Nevertheless, most managers are not expected to oppose such policies, and, consequently, this paper does not examine them.

In contrast to type 1, 3, and 4 policies, managers could differ on type 2 policies, and variations in firms' response to such policies is expected. This paper therefore focuses on type 2 policies only. Literature identifies multiple motivations for firms to adopt type 2 policies. First, they are adopted in response to the expectations of and the pressures from external institutions (Hoffman, 1997). Adopting them provides firms with legitimacy, thereby serving their long-term profit and non-profit objectives. Perhaps firms in pollution-intensive industries or industries with bad reputations of complying with environmental laws are more likely to adopt them. Type 2 policies may also be considered normatively appropriate: the 'right things to do'. Similar arguments can also be made by employing the stakeholder theory and the corporate social performance perspective (see below). The second category of explanations identifies strategic reasons geared towards potential long-term benefits. Firms could preempt and/or shape environmental regulations if they themselves respond to such policies (Fri, 1992; Reinhardt, 1999) and therefore reap first-mover advantages (Porter and van der Linde, 1995; Nehrt, 1998; for a critique see Rugman and Verbeke, 1998). Similarly, technologically advanced firms could raise the cost of entry for their rivals – the assumption being that higher standards will lead to stringent regulations (Salop and Scheffman, 1983; Barrett, 1991).

These explanations correctly identify non-profit and long-term (potential) profit reasons (though not amenable to formal investment appraisal and not meeting the *ex ante* criteria) for adopting type 2 policies. However, they inadequately explain *variations* in response – why do firms *selectively* adopt them?[3] For example, why does firm X consider policy A but not policy B as 'the right thing to do' although both policies have similar characteristics? For example, why did Eli Lilly adopt the Chemical Manufactures Association's Responsible Care Program but not the ISO 14001 programme, although both encourage firms to adopt type 2 environmental management systems (see Prakash, 2000a,b)? Or, why does firm X but not firm Y believe that adopting policy A is the 'right thing to do'? For example, why did only 13% of the targeted firms adopt the Environmental Protection Agency's 33/50 programme that encourages firms to reduce the emission of 17 specified chemicals by 33% by 1992 and by 50% by 1995 with 1988 as the benchmark (Sarokin, 1999)?

This paper argues that *selective* adoption can be more fully explained by examining dynamics internal to firms. It focuses on the role of policy-supporters in generating consensus or, if faced with opposition, lobbying the top management to mandate policy adoption. It does not deny the importance of external factors; rather, it highlights that, in the context of beyond-compliance policies, managers have autonomy to interpret the impact of external pressures on the long-term profit and non-profit objectives. Hence, intra-firm politics is important in explaining variations in adoption across firms for a given policy or within a firm for a set of similar policies.

Let me illustrate (for details see Prakash, 2000a). In the 1980s, Eli Lilly was faced with new regulations to replace its single-walled underground storage tanks. It had three routes for replacement, each complying with the new regulations but having different cost implications. Policy-supporters advocated the most expensive route (which minimized the chances of tank leaks), which exceeded the least-cost option by about \$30–40 million.

[3] For a discussion on selective adoption of beyond-compliance policies that focus on factors external to firms, see the article by Esty and Porter (1998). Also, Reinhardt (1999) examines factors external (industry structure) and internal to firms (organizational characteristics) in explaining selective adoption.

Some others, policy-sceptics, however, wanted Eli Lilly to opt for the least-cost route. Notwithstanding significant capital expenditures, Eli Lilly did not subject this project to any formal investment appraisal process because the goodwill benefits were difficult to quantify. Though policy-supporters did not offer any quantitative estimates, they highlighted the long-term benefits, profit and non-profit, of adopting the most expensive route. Policy-sceptics, however, did not agree with their assessment because no concrete profit estimates were available. After a significant internal debate, Lilly opted for the most expensive route (but environmentally safest) and mandated that all its facilities should replace underground tanks with above-the-ground tanks.

However, in the 1990s, Lilly was confronted with the question of whether it should mandate its facilities to adopt the ISO 14001 environmental management standards. Again, there were two broad groups of managers: policy-supporters advocating it and policy-sceptics questioning its benefits. As in the previous example, this policy could not be evaluated by any standard investment assessment procedure. Although the financial commitment for ISO 14001 was meagre compared to investments in storage tanks, this policy did not become an integral part of the corporate environmental programme. The policy-supporters could neither generate the consensus nor convince the top management to mandate its adoption. Their interpretation of the demands of the external environment did not persuade either the top management or the policy-sceptics. Thus, the role of intra-firm dynamics was critical in ensuring that the type 2 policy on storage tanks was adopted while that on ISO 14001 was not adopted.

EXISTING THEORIES: STRENGTHS AND LIMITATIONS

Procedural and substantive efficiency

Efficiency-based theories – particularly neoclassical and transaction cost economics – view firms as maximizing profits (to cite a few, Coase, 1937; Alchian and Demsetz, 1972; Jensen and Meckling, 1976; Fama, 1980; Williamson, 1985; Hirshleifer, 1988). This leads to the following question: how do firms maximize profits? Drawing on Simon's (1957) notion of substantive and procedural rationality and insights from the behavioural theory of the firm (Cyert and March, 1963), this paper distinguishes between two notions of efficiency: substantive and procedural. The former suggests *what* policies ought to be adopted while the latter suggests *how* they should be adopted. This paper applies these concepts to efficiency-based theories – substantive efficiency to neoclassical theory and procedural efficiency to transaction cost theories. It argues that no matter which definition we adopt, efficiency-based theories cannot adequately explain why firms selectively adopt type 2 policies.

Theories based on substantive efficiency assume that managers are fully rational and have clear expectations about the future costs and benefits of a policy. Such theories, particularly neoclassical economics, therefore focus on policy outcomes rather than processes leading to them. We can hypothesize that substantively efficient firms will adopt only those type 2 policies that *ex ante* maximize profits as demonstrated through formal appraisal procedures. What if, as observed in reality, managers cannot quantify profits, or type 2 policies are viewed to serve non-profit objectives? Clearly, theories based on substantive efficiency offer little help in this regard. It could perhaps be argued that substantive efficiency is an instrumental criterion – this is how firms ought to behave. If treated as a descriptive criterion, we should focus on systemic, not firm-level, outcomes (Alchian, 1950). This paper does not dispute the usefulness of substantive efficiency for certain research questions. However, it is not helpful in answering my research question that focuses on firms as units of analysis (for a succinct critique of neoclassical economic theory, see the Nobel Prize lectures of Simon, 1979; Coase, 1993).

Theories assuming that managers are procedurally efficient view managers as boundedly rational – 'intendedly rational but limitedly so' (Simon, 1957, p ix). If managerial behaviour is guided by procedures that seek to maximize profits, such behaviours are procedurally efficient. This of course assumes that such procedures, on average, have tended to produce substantively efficient outcomes. Simply having a procedure in place to maximize profits constitutes 'intended rationality' only; evidence of their success, on average, makes them procedurally efficient.

Neoclassical economics treats firms as unitary actors, positing that firms maximize profits without sufficiently explaining how they actually do it (Simon, 1957).[4] In contrast, since transaction cost economics assumes that boundedly rational managers seek to minimize transaction costs (a procedural guideline), it can be interpreted to focus on procedural efficiency (to cite a few, Coase, 1937; Williamson, 1985. For a critique of Williamson see Granovetter, 1985; Ghoshal and Moran, 1996; Roberts and Greenwood, 1997). This paper interprets transaction cost theories to suggest that managers view investment appraisal procedures as required tools for evaluating investments (such as 'make' or 'buy' decisions). Since maximizing a firm's profits is the primary managerial objective, policy processes are *consensual*. This is not to say that managers have identical preferences on environmental policies. However, since there is consensus that policies must meet or exceed the profitability criteria, different managerial preferences do not clash in the policy-making processes.

If firms cannot employ investment appraisal procedures or if policies are adopted due to non-economic motives, theories embodying procedural efficiency offer little help in predicting whether a type 2 policy will be adopted. Thus, efficiency-based theories, whether employing the notion of substantive rationality (neoclassical) or procedural efficiency (transaction cost), are inadequate to explain the research question.

[4] Other theories also treat firms as unitary actors. These include the 'moral person' theory of moral agency and the 'person-ficta' interpretation of corporations in law. The distinctive aspect of neoclassical economic theory is its emphasis on the role of markets in allocating resources and in harmonizing the pursuit of individual and collective welfare.

Institutional theory, stakeholder theory, and the corporate social performance perspective

I now turn to the literatures on institutional theory, corporate social performance, and stakeholder theory that offer useful insights for examining the adoption of type 2 policies. The institutional theory focuses on the impact of external institutions on policies of firms (Scott, 1987; Zucker, 1988; Oliver, 1991; Meyer and Scott, 1992; Hoffman, 1997). In contrast to efficiency-based theories that privilege two institutions – markets and governments – institutional theory takes into account other social institutions as well. Questioning the atomistic accounts of organizational policy-making, it suggests that firms are not profit maximizers; their policies reflect external pressures for legitimacy. Of course, different institutions have varying capacities to influence firms. This theory would predict that firms adopt type 2 policies in response to pressures from key external institutions, and managers would have little autonomy in this regard (Hoffman, 1997, p 6).[5]

The efficiency-based perspective views the social objective of business as to maximize shareholders' wealth (Friedman, 1970). In contrast, the literature on corporate social performance (CSP), responsibility (CSR1), and responsiveness (CSR2) argues that firms have other societal responsibilities as well (Preston, 1975). Carroll (1979, 1995) views CSP as having four components: economic, legal, ethical, and philanthropic. In the instrumental sense, CSP policies may positively impact firms' financial performance (Davis, 1973; Ackerman, 1975; Preston and Post, 1975; Preston and Sapienza, 1990; Jones, 1995; for a review and critique see Wood and Jones, 1995; Griffin and Mahon, 1997). Further, firms could be reactive, defensive, accommodative, and proactive in dealing with social issues (Wartick and Cochran, 1985; Carroll, 1995; for a critique see Wood, 1991). Thus, it could be argued that, since type 2 policies represent proactive CSP, they are adopted by firms.

The CSP approach is criticized for lacking a coherent theoretical framework to collect,

[5] However, Oliver (1991) does acknowledge that 'agents' may have autonomy even in an institutionalist perspective.

organize, and interpret data and it is suggested that the stakeholder theory provides an appropriate framework for these tasks (Clarkson, 1995). This theory suggests that firms should design policies taking into account the preferences of multiple stakeholders – stakeholders being 'any group or individual who can affect or is affected by the achievement of the organization's objectives' (Freeman, 1984, p 46). Unlike efficiency-based theories that posit firms to maximize shareholder's wealth only, the stakeholder theory provides a new normative, instrumental, and descriptive rationale for firm action that takes into account objectives of multiple stakeholders (Donaldson and Preston, 1995). There is also a literature that examines the impact of adopting a stakeholder approach on firms' economic performance (Cochran and Wood, 1984; Barton *et al*., 1989; Kotter and Heskett, 1992). Scholars have also explored firms' response to demands from multiple stakeholders, especially if firms do not have sufficient resources and/or demands are in conflict (Wood and Jones, 1995).

Since stakeholders are not alike, the literature distinguishes between primary/secondary stakeholders, owners/non-owners, voluntary/involuntary risk bearers, and legitimate/illegitimate stakeholders. Mitchell *et al*. (1997) suggest that stakeholders should be classified by their salience for managers in terms of power, legitimacy, and urgency since this better explains who and what managers should focus on. Thus, the classification of stakeholders (and managerial action in response to their demands and expectations) could vary across policies (or situational uniqueness) and across managers. As this discussion suggests, scholars have integrated the CSP perspective with the stakeholder theory and developed testable hypotheses regarding CSP policies firms could adopt (Wood and Jones, 1995). This also tests the descriptive and instrumental claims of the stakeholder theory (as Donaldson and Preston (1995) point out, normative claims are not hypothetical but categorical).

Based on the above discussion, it can be hypothesized that firms adopt type 2 policies only in response to demands from key stakeholders (in terms of power, legitimacy, and urgency) and institutions. However, different stakeholders and institutions may have different expectations; sometimes expectations may even be in conflict (Wood and Jones, 1995). It is critical to examine how managers interpret these expectations and employ them to push their agendas on type 2 policies.[6] Indeed, some scholars of stakeholder theory and CSP perspective identify managers as an appropriate unit of analysis (Wood, 1991; Clarkson, 1995; Mitchell *et al*., 1997). For example, Wood (1991), while examining the principles, processes, and outcomes for CSP at individual, organizational, and societal levels emphasizes the role of managerial discretion.

This paper draws insights from institutional theory, stakeholder theory, and the CSP perspective and relates them to dynamics within firms as conceptualized in power-based and leadership-based theories. The point of departure is that this paper does not view managers as passive recipients of external pressures. Since 'agents' have autonomy in the realm of type 2 policies, explanations focusing on external 'structures' only, particularly markets and governments, are under-specified. Further, managers do not have homogeneous preferences on type 2 policies. Thus, in addition to power, legitimacy, and urgency dimensions of stakeholders that Mitchell *et al*. (1997) identify, it is important to examine how managers interpret external pressures to advocate their agenda.[7] Power, urgency, and legitimacy, dimensions of stakeholders in relation to a given policy, therefore, become outcomes of intra-firm dynamics, specifically, the discursive struggles between the policy-supporters and the policy-sceptics. The next section discusses the power-based and leadership-based perspectives on such dynamics.

[6] In this context, see Suchman's (1995) treatment of 'inside-out' strategic legitimacy versus 'outside-in' institutional legitimacy as well as the discussion by Quinn and Jones (1995) on instrumental and intrinsic approaches to ethical decision-making.

[7] As Reinhardt (1999) points out, this could also lead to 'agency abuse' where firms over-invest in environmental programmes.

TYPE 2 POLICYMAKING WITHIN FIRMS

This paper examines selective adoption of type 2 policies and it suggests that dynamics internal to firms are critical in answering this question. Though firms are encouraged by external institutions and stakeholders to adopt type 2 policies, policy-supporters, policy-neutrals and policy-sceptics interpret these pressures differently. Thus, adoption or non-adoption of a policy depends on the relative power and persuasive abilities of the two factions (policy-neutrals are not critical to these dynamics).

Power-based processes

The term 'power' has many meanings. This paper uses it to describe the ability of manager A to influence outcomes in the wake of opposition from manager B. For example, policy-supporters may force adoption of type 2 policies although policy-sceptics may oppose it. Further, manager A may also force manager B to change his/her behaviour in a way that he/she would have not done otherwise (Weber, 1947; Dahl, 1957; Pfeffer, 1981; Mitchell *et al*., 1997). For example, policy-supporters may impose the adoption of ISO 14001 environmental management standards that policy-sceptics oppose. Further, if policy-sceptics are located at the facilities, they are forced to implement new management systems, requiring changes in their extant ways of functioning.

It is instructive to examine the bases of power and why some managers are more powerful than others. Etzioni (1988) identifies three types of power – coercive, material, and symbolic. Coercive power is based in control over instruments of coercion. For example, some managers may control workers by physically intimidating them. Materially powerful managers control instruments of material well-being. For example, a supervisor can control compensation and promotions of a subordinate. Symbolic power suggests that managers control normative symbols that bestow prestige. For example, a supervisor may have the ability to decide on the designations of its subordinates. Or, the supervisor could control allocation of work responsibilities: the favoured ones could work on prestigious and high-visibility projects. For the purpose of this paper, material and symbolic bases of power are relevant. Hierarchically superior managers typically have symbolic and material power over subordinates. Type 2 policies are adopted by a power-based route if policy-supporters are either hierarchically superior or can capture the top management and convince it to adopt their perspective.

Power-based theorists provide an important perspective on why firms arise and how they function. They point out that firms do not arise to internalize efficiency gains; they represent distributional conflicts (Marglin, 1974; Edwards, 1979; Perrow, 1979). Radical scholars view firms as instruments to dominate labour and to facilitate accumulation of wealth. In essence, power-based theories recognize that while managers may have conflicting preferences, policies are adopted only if supported by more powerful (often hierarchically superior) managers.

Why do managers support or oppose a type 2 policy and why are they unwilling to revise their preferences? First, since type 2 policies cannot be evaluated by 'objective' methods that are agreed upon by all the managers, there is less scope for narrowing differences. Second, managers often have vested interests in favouring or opposing a given policy. As Williamson (1964) argues in one of his earlier works, managers maximize utility functions that include variables such as status, salary and prestige. It is conceivable that environmental managers support type 2 policies since this increases their departmental budgets and headcounts. This, in turn, creates promotional opportunities for them and also increases their prestige within the organization.

To distinguish power-based policy processes that are marked by *imposition* from other non-coercive processes, we should expect to find evidence of dissent that is overcome through imposition from the above. Policy-sceptics are not predicted to change their preferences (as reflected in their behaviour) about the desirability of such policies. Their discomfort could manifest itself in a variety of ways such as expression of disagreement in meetings, non-enthusiastic implementation of the adopted policy or even 'guerilla warfare' to derail the policy. We can hypothesize that the level and intensity of opposition will be influenced by factors such as the extent of their disagreement and the fear of retribution. Importantly, the level of opposition also depends on the extent of organizational change required to implement a policy. If the change is significant, 'losers' are expected to have incentives to resist it, and perhaps power-based processes are then the only route to have such policies adopted.

Leadership-based processes

Leadership is a highly researched issue in organizational theory (for a literature survey, see Chemers and Ayman, 1993; Yukul, 1994; Luthans, 1995; Northouse, 1997). Similar to power-based theories, leadership-based theories also suggest that certain managers play key roles in creating or modifying policies (Barnard, 1938). Unlike the dominant actors in power-based processes who impose their preferences, leaders are consensus-inducers. They have both the political savvy and, yet, more ennobling and ethical goals (Lipman-Blumen, 1996). Importantly, policy consensus may not arise spontaneously (as in the Hayekian notion of spontaneous cooperation); interventions of leaders are required. Thus, leaders have the ability to build a shared vision and foster systemic and long-term patterns of thinking through dialogue (Selznick, 1957; Senge, 1994; also see Weick, 1995).

Leadership-based theories suggest that the presence of leaders is essential for firms to arise and function (Barnard, 1938). This perspective of the nature of firms contrasts with that of Williamson, who views hierarchies as artifacts to economize on costs of labour's opportunism. However, Williamson's critics argue that managers may also behave opportunistically (hierarchical failure) by unfairly appropriating profits (Miller, 1992). Firms cannot therefore be viewed simply as artifacts to mitigate market failures; the role of leadership is important.

In her classic book, *The Connective Edge* (1996), Lipman-Blumen identifies three general styles employed by leaders: direct (managers tightly define their goals and achieve leadership by outstanding performance), relational (managers lead by collaborating, contributing and empowering people to achieve respective individual goals) and instrumental (managers employ personal relationships and organization politics to achieve their goals, while allowing others to shape the pathways to those ends). Intra-firm dynamics in adopting type 2 policies are leadership based if they reflect a conscious building of consensus by policy-supporters. Since these policies cannot be demonstrated to increase quantifiable profits, or in some instances create 'losers' from organizational change, they could initially be opposed by policy-sceptics (or indifferently received by policy-neutrals). Some may predict that due to inter-manager conflict policies are either shelved or adopted by top-management imposition (a power-based processes). However, there is a third route as well. Policy-supporters may repackage such policies, remove the objectionable but unimportant aspects, and enable policy-sceptics to reassess their impacts. Instead of relying on quantifiable profits as the sole criterion, policy-supporters may suggest employing multiple criteria to assess the desirability of policies. For such arguments to be persuasive, the credibility and expertise of policy-supporters is important.

In both power-based and leadership-based processes, policy-supporters are expected to portray type 2 policies as serving long-run profit and non-profit objectives of their firms. Although policy-supporters may make claims about increases in long-term profits, they provide no estimates. This suggests that in some instances profit no longer remains an 'objective' concept whose measurement is invariant across actors. This paper is not arguing that established procedures of project appraisal are irrelevant. They matter very much and that is why it is difficult for policy-supporters to justify why their pet policy should not be subjected to the formal rules of project appraisal. Importantly, such exceptions occur often in evaluating environmental projects, and this paper proposes one way of examining the processes that lead to such exceptions.

Further, this paper is not suggesting that leaders never exercise power or *vice versa*. It focuses on leadership-based and power-based *processes*. Under different circumstances, both internal and external to a firm, a given manager may resort to imposing policies instead of generating consensus around them (see below).[8] An interesting research question not examined here is under what conditions, if at all, managers with specific attributes (professional background, levels of cross-functional exposure etc) are more prone to impose their preferences about beyond-compliance policies than building shared understanding around them. Arguably, leadership-based processes are akin to power-based processes where power is exercised subtly in terms of shaping opinion. Scholars following the perspectives of Foucault (1970) and Gramsci (1988) could also be expected to argue along the same lines. If power is defined in such an all-encompassing manner, it becomes impossible to make falsifiable predictions about whether or not power has been exercised. This paper has conceptualized power-based processes in a specific way: policies are adopted in the wake of continuing opposition from policy-sceptics; there are clearly identified managers who exercise power (policy-supporters) and their bases of power can be clearly identified. Importantly, power-based and leadership-based processes arise under different conditions and could lead to different outcomes (see below).

The above discussion on power-based and leadership-based processes leads to the following propositions.

1. Type 2 policies require senior-management (the rank of Vice-President and above) support even when they do not require significant up-front and/or recurring expenditures.
2. Type 2 policies involving significant organizational changes (in terms of departmental budgets, reporting relationships and work responsibilities) that create diffused benefits but impose concentrated costs are likely to be opposed. Consensus-inducing or leadership-based processes are therefore unlikely to succeed. If such type 2 policies are adopted, it is by the coercive power-based route.
3. Power-based processes are likely to succeed in organizations that have environmental affairs (or environmental, health and safety) organized as a separate department and led by a senior manager (the rank of Vice-President and above).
4. Leadership-based processes are likely to succeed if policy-supporters have expertise in the issue area. Expertise could be operationalized in terms of variables such as technical qualifications, experience in the issue area and demonstrated success in solving related problems.[9]

IMPLICATIONS AND LIMITATIONS

Many environmental policy scholars argue that firms are often oblivious of the 'low-hanging fruit,' type 1 'win–win' projects that generate quantifiable profits and deliver superior environmental performance (Porter and van der Linde, 1995). Hence, stringent environmental laws are required to force firms to adopt such policies. Some projects are certainly win–win, especially those that lead to pollution prevention or reduction. However, type 2 policies such as adopting new management systems (such as ISO 14001 and the EMAS) that have become popular in the 1990s cannot be demonstrated as *ex ante* profitable.[10] This suggests that a policy focus on win–win

[8] For empirical illustrations, see chapter 4 of Prakash (2000a). Mitchell *et al*. (1997) recommend that managers consider the *overlap* of power, legitimacy and urgency dimensions in identifying and in responding to stakeholder demands. Since managerial perceptions may differ, power-based and leadership-based processes explain how and which of these perceptions prevail.

[9] This is because leaders establish causal linkages between the adoption of type 2 policies and the long term benefits (economic or non-economic) for the firm. They convince the sceptics that the pressure from the external environment for adopting type 2 policies is significant (in terms of power, legitimacy and urgency – *à la* Mitchell *et al*., 1997): there are non-trivial benefits of adopting or non-trivial costs of not adopting a policy.

[10] In this context see Prakash (1999) and Kollman and Prakash (2001).

projects is misplaced in that the win–win rhetoric creates false expectations, which will eventually lead to managerial backlash. This paper, therefore, submits that environmental regulations of the future need to be justified on non-economic grounds as well because their economic rationale at the firm level may be difficult to demonstrate.

Theoretical implications

Research projects often focus on either theory testing or theory building. Theory testing is useful when the existing theoretical tools are sufficient to examine a given research question. Of course, in the process of testing existing theories, researchers may suggest modifying them. Theory building is useful when existing theoretical tools are insufficient in explaining a given puzzle. This paper is in the realm of theory building. Efficiency-based theories are under-specified to explain why firms selectively adopt type 2 policies. Though institutional theory, stakeholder theory and the CSP perspective offer useful insights to understand the research question, they are under-specified since they do not adequately focus on dynamics internal to firms. These theories and perspectives along with power-based and leadership-based theories of intra-firm dynamics provide a better specified explanation for why firms selectively adopt type 2 policies.

Two theoretical implications flow from this paper. First, ontologically, it argues for methodological individualism: individuals are the *ultimate* (not the only) unit of analysis (Buchanan and Tullock, 1962). Thus, firms should not be reified and their policies should eventually be traced to preferences, power and strategies of individual managers. As discussed before, there is an established literature on the unpacking of firms and this paper has built on this tradition. This paper is not questioning the validity of other levels of analysis. Nor is it arguing for an under-socialized conception of managers. For other research questions, firms remain a useful level of analysis. However, unlike neoclassical economics and the institutional theory that privilege external 'structures', it argues that 'agents' have autonomy regarding type 2 policies, and, consequently, their preferences, power and strategies have crucial bearing on policy outcomes.

Second, this paper suggests that some policy processes and outcomes cannot be adequately understood by employing one theory; rather, this requires employing multiple theories or conceptual lenses (Allison, 1971). It has drawn upon the institutional theory, the stakeholder theory and the CSP perspective that provide excellent insights regarding external pressures for firms to adopt type 2 policies and has woven them with power-based and leadership-based theories of intra-firm dynamics. It views these theories and perspectives as being complementary. Focusing only on dynamics internal to firms or external to firms would lead to under-specified explanations of policy outcomes.

Limitations

My research question could also be examined by employing other theories such as resource based (Penrose, 1959; Peteraf, 1993), evolutionary (Nelson and Winter, 1982), ecology (Hannan and Freeman, 1977) or garbage-can (Cohen *et al*., 1972). Unlike this paper, these theories do not subscribe to methodological individualism in that they do not view policies of firms as conscious artifacts that can be traced to preferences, power and strategies of individual managers. These theories would therefore suggest different explanations for why firms selectively adopt type 2 policies. Hence, this paper should be viewed as a modest attempt to examine the research question by employing some of the many possible sets of theories.

This paper has focused on policy adoption only. It has not examined or suggested hypotheses regarding the durability and efficacy of power-based processes versus leadership ones. Perhaps power-based policies are effective in the short-run only. The leadership route is likely to produce more durable and effective outcomes in the long run given that policy-sceptics could have ways to oppose imposed policies, and, if driven to desperation, even to sabotage them. On the other hand, if top management's intent is clearly communicated, and power-based policies are able to meet their stated objective, the sceptics may reconcile to new rules of the game. Thus, there are theoretical reasons to argue in favour as well as against power-based policies in the context of their long-run durability and efficacy.

To examine intra-firm dynamics, this paper classified managers as policy-supporters, policy-neutrals and policy-sceptics. In the tradition of Samuelson's (1947) 'revealed preference', this paper infers preferences for type 2 policies from managerial behaviours. Methodologically, however, this is an imperfect way of assessing preferences since preferences and exhibited behaviours may not have direct correspondence. The same set of preferences can translate into different behaviours given varying incentives. Further, it is important to understand why managers have given sets of preferences, what values they hold on environmental issues and how they prioritize short-term quantifiable profit objectives over long-term non-quantifiable profit as well as non-profit objectives.[11]

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[11] For a discussion on why some managers are policy-supporters while some others are policy-sceptics, see Prakash (2000a).

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