

How institutional forces are saving the planet

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When regulatory bodies and industry forces take a stand on environmental concerns, they ultimately spawn innovative responses in companies.

Environmental disasters make headlines and enrage stakeholders. Think of the infamous 1989 Exxon Valdez oil spill, or the major health crisis brought on when a ship offloaded 500 tons of toxic waste on the Ivory Coast in 2006. Environmental concerns are now an important part of companies' strategic choices due to increased social awareness of organizational wrongdoing and stakeholder pressure.

When it comes to environmental issues, there are two different theoretical approaches: institutional theory and the resource-based view of the company (RBV). Institutional theory acknowledges the role of external forces in shaping organizational activity and emphasizes the importance of legitimacy. RBV dictates that internal resources can be a source of competitive advantage.

"Each of these approaches contains a kernel of truth that explains environmental innovation", say [Pascual Berrone](#) (IESE), Liliana Gelabert and Andrea Fosfuri (Universidad Carlos III) and Luis R. Gómez-Mejía (Arizona State University). Yet, in their paper "[Can Institutional Forces Create Competitive Advantage? Empirical Examination of Environmental Innovation](#)," the professors argue that "none provides by itself a full explanatory account of the phenomenon."

In other words, environmental innovation depends on a mix of institutional theory and RBV.

Moreover, government regulation and normative forces stemming from industry do influence companies' propensity to innovate in environmental-related projects.

To prove these points, the paper looks at the environmental patents and citations of 340 publicly traded companies from polluting industries in the United States. The results are clear: Institutional pressures can be a source of competitive advantage, and regulatory forces are becoming more strongly associated with environmental innovations, as the intensity of companies' R&D activities increases.

Institutional theory and environmental issues

Even companies follow the leader. A central tenet of institutional theory suggests that institutional pressures lead organizations to adopt similar structures, strategies and processes. This phenomenon when external forces band together to make companies more alike is called "organizational isomorphism."

Companies imitate the practices used by other organizations in order to reduce environmental uncertainty and conform to social expectations. As a result, companies gain social support and they avoid the pitfalls of newness.

Institutional theory has been used extensively in environmental management, and a key point is legitimacy. Because of their impact on the natural environment and society, companies tend to be scrutinized more intensely by different stakeholders such as government, media, consumers and activists. Society is more aware of organizational wrongdoing and environmental demands, and institutional theory predicts that companies can gain legitimacy by reducing their impact on the environment and exhibiting good environmental performance.

A resource-based view

The resource-based view of the company argues that value-creating strategies are those that create resources and capabilities with profit potential. Resources and capabilities include tangible inputs such as people, property and capital, and intangible resources like skills and know-how.

The endurance of profit from these resources and capabilities is determined by their uniqueness, scarcity and value. These features enable a company to obtain above-normal rates of return, since it is difficult for a company's rivals to obtain or duplicate these

resources and capabilities in the market.

The RBV view proposes that innovation is essential for organizations to succeed. Indeed, it is a major challenge for technological innovators to obtain talented scientists and engineers who can develop successful innovation that can be taken to the market. In the world of environmental management, RBV is seen as the most influential framework.

In 1995, Hart argued that good environmental behavior could be a source of competitive advantage. When companies respond effectively to environmental demands and challenges in innovative ways, they gain new resources and develop capabilities that can provide an edge over competitors.

Integrating the two

This paper proposes that one theory is not enough: neither institutional theory nor RBV can fully explain organizational behaviors related to environmental concern. A hybrid is the solution.

"In real-life situations, a company is likely to contemplate both the relevance of proper responsiveness to institutional forces and the importance of creating valuable resources. Therefore, a combined approach can provide a clearer framework to explain decisions regarding creating competitive advantage," state the authors.

Combining the two theories and applying them to the natural environment suggest that institutional forces will pressure companies to heed their environmental concerns. Institutional pressures constrain organizations' actions while creating new business opportunities.

In order to seize these opportunities, companies need to develop increasingly novel and complex technologies that reduce or eliminate toxic waste so that rivals do not mimic their actions. Innovation in environmental-related issues is essential to create capabilities that enable the company to seize market opportunities for sustainable development.

The forces at work

When it comes to environmental issues, there are really two institutional pillars that provide structure and meaning to organizational behavior: regulative and normative.

The regulatory element, typically conceived by governments, provides explicit guidance

through rules, controls, rewards and sanctions.

The normative element involves a less explicit system of norms and values, which tend to come from the industry and professional organizations that establish standards for operations.

The research finds that both of these forces - regulatory and normative - significantly influence whether or not a company innovates environmentally and to what degree.

While government regulation appears to be stronger, how companies react depends on the quantity and type of resources that they own. Thus, one should not expect different companies to react in the same manner to institutional pressures. Berrone and his colleagues found that firms with more specific resources (i.e., those that are capital intensive and invest highly in R&D) are more sensitive to environmental external pressures and therefore more likely to respond to them in an innovative way.

Overall, this paper makes important contributions to the study of environmental innovation. By combining insights from institutional theory and RBV, it strengthens the explanatory power of both.

It also analyzes how institutional factors affect a company's propensity to innovate. By studying those American companies that continue to pollute, the authors prove that institutional pressure - governmental and industrial - can inspire innovation and create competitive advantage.

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