Beyond Politics: Do directors with a political background make firms greener?

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Abstract

This study examines whether former politicians on corporate boards may be helpful for the implementation of green strategies. Following resource dependence theory and stakeholder theory, we argue that directors with a political background can provide firms with resources that are valuable for firms in environmentally sensible industries in two respects. First, through their social capital and legitimacy, former politicians may help firms in mitigating potential stakeholder pressures and anticipate future regulations. Second, environmentally experienced former politicians may support firms in effectively and substantively implementing an environmental strategy. We also consider the possibility that appointments of politicians to the board are purely symbolic acts intended to enhance the public's image, without any change in the environmental performance of the firm.

INTRODUCTION

Outside directors on corporate boards can help firms by providing a multitude of resources. They may support top management teams in decision making and problem solving or supply specialized expertise on law, banking, or public relations, provide expertise about powerful groups in the community or create legitimacy necessary for the firm's survival in its institutional and business environment [1, 2, 3].

Only recently, an emerging literature focuses on the role that former politicians may play on corporate boards, with a particular emphasis on their social capital stemming from their relations to governmental institutions [4]. The focus of these studies is the substantive aid that former politicians on boards can give to firms in order to reduce uncertainty from the governmental environment and thus to aid in the "political strategy" of a firm. Especially in regulated industries, this co-optation strategy seems to pay off as companies with former politicians on the board were found to have a better financial performance compared to those without former politicians [5].

In this study, we extend this literature by investigating whether former politicians on boards have an effect on another important area of firm strategy: firms' environmental management efforts and results. Besides being an increasingly important area of firm strategy that has recently attracted much academic attention [6, 7], environmental management also shows some similarities to political strategy in that it shares some of the same human and social capital patterns and thus requires the service of similar external resources.

Specifically, we argue with resource dependence theory [3] that former politicians on boards can substantially contribute to environmental management through their advice and counsel, channels of communication and information between the firm and external organizations, preferential access to commitments or support from important elements outside the firm, and legitimacy. We thus consider explicitly the resource endowments of politicians and integrate the same into a model of environmental management on the firm level.

We further argue with stakeholder theory [8] that firms in polluting industries are potentially subject to several stakeholder pressures and former politicians on the board may help mitigating these pressures by aiding in substantially implementing a green strategy. In addition, we explore whether former politicians could be appointed to corporate boards as a more "symbolic" act [9] that is to signal to stakeholders that the respective firm is engaging or at least planning to engage in green production efforts and thereby to create legitimacy for the firm. In this case, the firm may mitigate stakeholder pressures for some time but would leave their level of substantive environmental performance unchanged or even deteriorate it [10].

Our work contributes to the literature on board performance by extending the analysis of director backgrounds from the focus on their contribution to the political strategy of the firm (i.e. managing the relationship of the firm with particularly the government as a specific stakeholder) to their potentially valuable impact on environmental performance. This will increase our understanding of the complex relationships between board appointments, specific firm strategies and eventual firm performance. Furthermore, we are contributing to the literature on environmental management and in particular the emerging perspectives of "environmental governance" [11] by investigating the influence of a specific type of external board directors on environmental performance on the firm level.

This study is important for two reasons: First, environmental performance per se has gained increasing relevance over the last decade as the public comes to a greater appreciation of the deteriorating externalities that many industries have for our planet. Exploring the antecedents of environmental performance may help to develop solutions for better environmental management, which, in turn, will help firms to address these public concerns. This, furthermore, relates our work to the accumulating body of evidence that substantial investments in environmental strategies may, in fact, pay off financially [7].

The paper is organized as follows. We first review the literature on the importance of firms' political strategies for financial performance and the emerging perspectives added to this literature by a focus on politicians as members of such boards. We then analyze what challenges firms face with respect to implementing an effective environmental strategy or otherwise managing the public expectations regarding environmental performance and match these challenges with the resources that former politicians on the board could potentially supply. Since we are in the process of data collection, we do not offer an empirical test in the current paper, but conclude with a short discussion of the implications of our theoretical discussion.

Literature Review

The potential benefits of close relations with the political arena as a means for establishing competitive advantages have long been a topic of inquiry by public policy researchers [12]. Firms seem to use political activities to establish social legitimacy or to influence regulatory processes around protectionism, environmental issues, military procurement and deregulation, prices and market entry [12, 14]. At the core of firms' political strategies lies therefore the attempt to gain and maintain access to those who make public policy. By means of this access firms may acquire

information that help them to anticipate changes in the policy environment, build strategic alliances with legislators and regulators, increase their ability to survive by decreasing uncertainty in the political domain, and influence regulatory and legislative processes [14]. In addition, firms use several tactics such as lobbying, making financial contributions, or mobilizing grassroots constituencies [15]. As a result, firms seem to profit from political connections by showing a higher financial performance than those not connected [16] and being more likely to be bailed out [17].

Despite this ample work on the effects of connections between the political and the corporate sector, the role of former politicians on corporate boards has only received scant attention. This surprises considering the apparent importance that firms assign to having politicians join their boards. In fact, between 1973 and 2007, the number of large corporate boards whose members include former government officials has grown from 14 to 52 percent suggesting that former politicians may provide some benefits for firms that other directors do not provide [18]. According to the extant literature, these benefits may be rooted in the fact that former politicians possess human and social capital that can be leveraged for firms primarily for influencing the political process in regulated industries [4]. These benefits seem to increase the more government service tenure and prior political service jobs with high complexity and prestige former politicians have accumulated. Accordingly, Hillman [5] finds that in particular in regulated industries, bringing former politicians on boards seems to pay off as firms with former politicians on boards show higher financial performance than firms without them.

We, however, believe that this focus solely on the impact that former politicians on corporate boards may have on the firm's political strategy overlooks important potential benefits that they may bring to firms regarding the active strategy formulation in an increasingly important area: firm environmental management. We explore, therefore, whether former politicians on the board can be helpful in aiding firms to develop substantive environmental strategies and to what extent firms would actually value having former politicians on the board. In a second step, we examine what actual effects regarding the firm's environmental performance and reputation as well as potential penalties the firm needs to pay for not complying with green regulations we may expect to happen when politicians are on the board. Finally, we explore whether the role of former politicians on corporate boards consists in giving substantive aid to crafting and implementing firm strategy or more in creating legitimacy for the firm as a more symbolic act without actually improving its environmental performance.

THEORY

Environmental performance is a major concern for society today. What started with minority groups such as the Green parties in the late 1970s and non-profit activity groups such as Greenpeace has become a worldwide movement, especially in the so-called developed countries. Waste-reduction, CO_2 emissions' reduction, or energy savings are major issues today, discussed in the political arena, pressured by activity groups, and increasingly demanded by consumers [11, 19]. Accordingly, institutional pressures for firms to become "green" are increasing, which suggests that individual firms will feel more and more compelled to show a high level of environmental performance in order to insulate themselves from negative reactions from their environment or to even benefit actively from these trends and turn their environmental management approach into a competitive advantage [11, 20].

Firms in polluting industries can be expected to be particularly subject to these pressures so that they face specific challenges. From the resource dependence theory (RDT) perspective,

organizations are constrained by a network of interdependencies with other organizations [3]. Interdependence may lead to a situation in which survival and continued success are uncertain as long as the actions of other organizations on which the firm depends are uncertain. Therefore, organizations take actions to manage external interdependencies [20]. In addition, the literature on stakeholder theory [9] suggests that active stakeholder management can effectively mitigate social pressures and even create financial benefits [21, 19].

Governmental institutions, in particular, are both a source of uncertainty and one of firms' primary stakeholders as they influence the rules of commerce, the structure of markets, the offerings of goods and services that are permissible, and the sizes of markets [22]. For firms in polluting industries, regulatory institutions such as the Environmental Protection Agency (EPA) may be particularly important as this agency prosecutes environmental offenders and annually publishes toxic spill data on a set of more than 500 regulated chemicals in the Toxic Release Inventory (TRI). The TRI has, in fact, by now become a highly regarded and extremely well publicized tool for assessing particular firm's environmental performance and may thus contribute to make other stakeholder groups well informed about firms' environmental performance records. Achieving a better fit between the firm's environmental profile and external environmental regulations, for example through compliance with existing rules or through influencing regulators, may thus cause fewer penalties and hence achieve a direct financial benefit. In addition, other stakeholders such as media organizations, activity groups, suppliers, or employees may be important stakeholders [11, 19]. While positive reports in the media or at least the avoidance of negative reports about a company may increase its reputation among customers, the support of activity groups such as Greenpeace may be a key requisite for building a positive image to the public, and suppliers as well as potential future employees may prefer a firm with a green image to a firm with a dirty one [10].

Hence, managing these interest groups and thereby reducing stakeholder pressures may be important for the survival of firms particularly in polluting industries, be it through investments into a strong environmental policy that leads to effectively greener production and thus the approval of these interest groups, or through a more symbolic approach [8] that attempts to sway the opinion of these stakeholders without actually going through the complex, time consuming and difficult process of setting up an effective environmental strategy. In addition, also from a moral perspective and, as extant literature has shown, from a market-oriented perspective firms may find reasons to engage in a substantial environmental strategy – a green strategy that goes beyond symbolic actions in the form of pure impression management. In fact, the empirical literature on environmental issues suggests that environmental investments could lead to financial gains, but only if these investments have top management support, are substantial and pro-active in the sense that firms do not just fulfill governmental requirements but actively and continuously shape their environmental strategy [7, 10, 23]. Such pro-active and intense environmental management programs could lead to above average returns in a number of ways. First, by creating legitimacy with environmentally concerned external stakeholders – as discussed above – which could lead to attracting new customers or benefitting from governmental subsidies, but also with internal stakeholders such as employees if these groups value a firm's environmental stance enough to extend the term of their cooperation (e.g., attracting and retaining good employees) or otherwise offer better exchange relationships [24]. Second, by developing complex organizational and hard-to-copy capabilities the firm may become enabled to more efficiently and competitively use firm assets to realize net cost savings and tie key stakeholders like suppliers, employees or customers closer to itself [25, 21, 26]. Finally, the development of these environmental capabilities can also lead to green product innovations that may allow the firm to

charge higher margins in the market. In essence, competitive advantage through environmental efforts is achieved if firms manage to develop a complex set of valuable, rare, hard to imitate or substitute resources and capabilities that allow them to positively differentiate from their competitors in a sustainable way [27].

However, implementing a substantial environmental strategy implies significant implementation challenges for a firm such as the environmentally-oriented redesign of the whole company [6], the introduction of an Environmental Management System [23], or an organization-wide involvement by going through the ISO14001 EMS certification [28]. Moreover, in order to achieve financial benefits by environmental performance, firms may need to build strong relationships with stakeholders [25, 19] or redesign the CEO's compensation system [10]. Organizations to become green and realize financial benefits at the same time, thus, need to go beyond simple compliance with regulations towards a pro-active, holistic, and ongoing environmental strategy requiring internal resources and capabilities such as technical information and implementation capabilities as well as external resources and capabilities such as relations to governmental institutions, the communication with activity groups and the management of media organizations. Altogether, the challenge for a firm is to actually create a functioning environmental management approach that leads to a good environmental performance of the firm and, in the process, potentially to higher revenues or lower costs.

How can former politicians on boards help?

So far we have identified two specific challenges for firms in polluting industries: first, managing uncertainty from the firm's environment sensitive to the (potentially low levels of) "greenness" of the firm and, second, potentially implementing a substantial environmental strategy for the purpose, for instance, to generate long-term financial performance benefits through a CSR-related differentiation strategy.

The RDT suggests that former politicians as directors may help to actively shape the political environment of firms by leveraging their contacts to and reputation within the political arena, and extant literature has already found evidence that their potential is well recognized by managers [5]. Yet, we argue that former politicians on corporate boards may also provide benefits to the firm through the provision of resources beyond the political process, and more specifically, through their help in substantially implementing an environmental strategy. First, former politicians may provide advice and counsel in dealing with regulatory processes and activity groups' management as well as substantial technical knowledge for implementing a green strategy. Second, former politicians may provide preferential access to resources in the form of contacts to external environmental experts for gaining external expertise in green technologies. Third, they may provide access to channels of information between the firm and environmental contingencies, for instance to decision in makers in regulatory agencies, which may allow the firm to exploit these linkages for anticipating future regulatory developments. Finally, they may provide legitimacy for the firm which may reduce close observation from regulatory agencies and activity groups.

We therefore assume that former politicians are potentially very valuable for firms in both implementing a substantive environmental strategy (arguments 1 and 2) as well as in managing stakeholders (arguments 3 and 4). This should be the case especially for firms in polluting industries where pressures from regulatory institutions and activity groups may be particularly high and where consumers may become increasingly demanding for "greenness" in times of the global warming increase and rising media coverage of environmental topics.

Hypothesis 1. Firms in industries with more potentially negative environmental externalities such as polluting industries hire more former politicians to their board of directors than firms with less potentially negative environmental externalities.

We now explore the potential contributions of former politicians more specifically by looking on the potential outcome they may bring to firms. Starting with their potential aid in creating a sound and effective environmental management strategy, we argue that developing such a strategy for the purpose of leading the firm to substantively good environmental performance is a difficult and highly involved task [6, 11]. Among other things, such a strategy may require detailed knowledge about legal constraints and political requirements, expectations from activity groups, in depth knowledge about technologies, or environmental data. Former politicians, especially when they have been working in environmental committees or have otherwise concentrated on environmental issues during their political career, may provide the firm with deep insights into environmental concerns such as a more accurate understanding of the "state of the art" of environmental technology, information about vendors of environmental technologies, or contacts to research and development centers in this area. Therefore, we argue:

Hypothesis 2. Firms with former politicians on the board pollute less than firms without them.

Besides implementing a substantial green strategy, there may be other ways for firms to attain a green image and realize financial gains whereby former politicians on corporate boards may be particularly helpful. In the following we will explore two such possibilities: lobbying and symbolic management.

In the US context, the environmental protection agency (EPA) is probably the most important source of institutional pressures for superior environmental performance for firms. Starting in 1970, the EPA has put an increasing number of toxic chemicals (currently more than 500) under regulation and required firms to report any spills, leaks or other breaches that allowed these chemicals to escape into the water, land or air. Annually, the EPA publishes these toxic spill data in the Toxic Release Inventory (TRI), which by now has become a highly regarded and extremely well publicized tool for assessing particular firm's environmental performance. Numerous academic articles are based on these data and analysts and shareholders do appear to pay attention to it [7]. In addition to showing the relative cleanness or dirtiness of particular firms (thus allowing a judgment as to the degree of their environmental efforts), high polluting firms are also very likely to be fined by the EPA for environmental violations. Besides monetary fines levied against firms, environmental enforcement lawsuits in the US also often turn directly against firm executives or directors, who may be sentenced to fines or even jail terms. Environmental law enforcement in 2008, for instance, resulted in $68.5 million in criminal fines and 57 years of prison time [29].

Following prior work [5], one conjecture within this context would clearly be that politicians may use their connections, reputation, and experience with political processes and environmental issues to avert potential environmental enforcement actions to protect firm assets and executive or director's personal liability. If that were the case we should find that firms with more former politicians on the board have fewer environmental enforcement rulings against them (or pay lower fines) – even if they have the same substantive environmental performance as other firms. This effect should be stronger the more tenure these politicians have, the more influential

positions they had in their active political career, and the less time has passed since their departure from politics [4].

> *Hypothesis 3. Firms with more former politicians on the board and similar environmental performance as other firms face fewer regulatory environmental penalties.*

We have argued that former politicians are taken onto boards because they can provide firms with valuable resources for implementing environmental strategies or because they may help firms in shaping their political environment. However, former politicians on the board could potentially also be used in a more symbolic way, for example by leveraging their personal reputation to gain legitimacy for the firm and thus mitigate stakeholder pressures. Prior research has shown that firms sometimes use symbolic actions in lieu of substantive underlying activities to reduce stakeholder pressures. Westphal and Zajac, for instance, found that the simple announcement of stock buybacks [30] or the announcement of enhancements in the quality of corporate governance [9] can lead to significant abnormal shareholder returns, even when no substantive actions to actually implement these announcements follow. In these examples, shareholders appear content to change their opinion of the value of the firm (and hence bid up their shares) purely based on observing the firm's announcements, and do not seem to realize that these are simply symbolic acts. In the current context, since politicians presumably amass connections, power, and prestige [4], firms may be tempted to use the very appointment of these politicians as a symbol to their various stakeholder groups that the firm intends to better its environmental performance. Several studies have indeed shown how the reputation of the corporate board can have benefits for the firm. Certo [31], for example, has found evidence that board prestige signals organizational legitimacy to investors in an IPO context, leading to an improved IPO firm stock performance. Similar, in a theoretical paper Hillman and Dalziel [11] link the construct of board capital to several potential advantages for firms, for instance, the attainment of legitimacy and the bolstering of the firm's public image.

We expect a similar effect when former politicians join corporate boards, especially the more the politicians in question have created for themselves the necessary prestige and believability that would signal to shareholders that they would actually be driving the firm to a better environmental policy. In fact, the very appointment of a reputable politician, particularly one with an environmental track record, could be used by such firms as a symbolic act intended to positively influence the perception of outsiders of the firm's environmental performance, even if the firm does not follow through with any substantive enhancements of that performance. If this happens, then the following should hold:

> *Hypothesis 4. Firms with former politicians on the board have a better environmental reputation (but the same or lower actual environmental performance) than firms without former politicians.*

Finally, since prior research has found that the human capital and social capital of former politicians will be higher the more tenure in political activities these former politicians have, the more complex and prestigious their tasks have been, and the less time has passed since their departure form politics [4]. In addition we argue that their human and social capital increases the more experience the former politicians have with environmental issues, for example by working for committees. Therefore we argue:

Hypothesis 5. The effects of hypotheses 1 to 4 will be stronger the more tenure in the political arena former politicians, who come to the board, have, the more complex and prestigious their tasks have been, the less time has passed since their departure from politics and the more experience with environmental issues they have.

Conclusion

We have discussed the potential contributions that former politicians on corporate boards may have for effectively implementing environmental strategies. Prior literature has discussed the purposes of politicians on corporate boards primarily as potentially influencing political processes for the financial benefit of the firm [5]. In addition, the benefits of former politicians primarily have been captured as human and social capital regarding political processes [4]. We extend this emerging research by considering politicians as valuable also for aiding firms in mastering other important strategic issues, notably environmental (green) management. In addition, we explore whether electing former politicians to corporate boards is done for substantially improving the environmental performance of the firm or rather as a symbolic signal to mitigate stakeholder pressures. By this, we first contribute to the literature on board performance and improve our understanding of the complex relationships between board appointments, specific firm strategies and eventual firm performance. We also contribute to the literature on environmental management, and in particular the emerging perspectives of "environmental governance" [11].

Furthermore, our study is valuable for managerial practice. Prior literature suggests that for firms in industries with low environmental performance and high waste production or emissions, for instance, in the chemical or the steel industry, there appears to be a high strategic potential for developing a competitive differentiation from competitors by creating a strong "green" strategy [7]. Our study provides insights about how and why the appointment of politically experienced directors can be a valuable and rare means to establish this strategic potential for competitive advantage by increasing the firm's environmental performance.

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