RSM Insight

Management Knowledge

12

4th Quarter 2012

ROTTERDAM SCHOOL OF MANAGEMENT, ERASMUS UNIVERSITY

The business school that thinks and lives in the future

RSM Erasmus ERASMUS UNIVERSITY

Environmental capabilities
and corporate strategy

by Luca Berchicci

Green thinking that would have met with nothing but contempt three decades ago is now firmly on the agenda of corporate boardrooms. Green thinking is increasingly having a clear impact upon how companies in a wide range of sectors across diverse geographies formulate and implement their long-term strategy and short- to medium-term tactics.

A growing number have embraced the challenges presented by the new reality and devised ways and means of making their business not only greener but also more cost-effective and ultimately more profitable, in what I would suggest is a classic case of a win-win scenario.

"To what extent does it pay for a company to be green?"

Governments and regulators are happier because their edicts have changed behaviour in the positive way that they envisaged. The public are happier because their environment is more conducive to good health and the collective conscience is salved. Companies and shareholders are happier because they have met their obligations while enhancing income.

Environmental capabilities

Adapting to the new way of corporate life demands that companies build or acquire a new set of what are often referred to as "environmental capabilities". Environmental capabilities can be briefly summarised as a new set of routines and norms that will help companies behave, and evolve, to cope with the additional responsibilities thrust upon them, and to sustain themselves environmentally and commercially in the long term. Some companies, as one might expect, are adapting well. Others are struggling to do so.

In this context, several questions suggest themselves. To what extent does it pay for a company to be green? Does it have any impact on the bottom line? Will additional layers of regulation necessarily improve a company's competitiveness by delivering enhanced performance? Does the need for environmental capabilities trigger a search for them if a company doesn't possess them? Does it make sense to go looking for them elsewhere rather than try to build in-house capabilities?

There is, of course, an obvious short cut to plugging any gap in a company's environmental capabilities: go down the time-honoured route of buying a rival company, plant or other facility which already has them in place. A recent paper that I co-authored - *Environmental capabilities and corporate strategy: exploring acquisitions among US manufacturing firms* - examines how acquisitions act as a transmission mechanism for environmental capabilities.

Why would environmental capabilities matter in acquisitions? At minimum, firms assess a potential target's environmental records as part of the due diligence process in order to minimise the possibility of acquiring a target that has significant potential for environmental liabilities. Discussions with managers who have been involved with numerous acquisitions indicate that environmental issues are commonly considered in the pre-acquisition phase.

Environmental issues are not the primary driver of acquisition choices, as firms generally choose targets that fit their strategic needs (eg, allowing them to gain access to a product or service market). However, environmental due diligence can either alter the terms of a deal or cause the firm to cancel a planned acquisition all together.

Increasingly, firms are assessing environmental performance to determine if a facility is undervalued and whether its performance can be improved through post-acquisition capability transfer. In 2000, for example, energy company Kerr-McGee acquired a facility in Savannah, GA, that had been cited for environmental and safety concerns. In making the acquisition, Kerr-McGee explicitly cited its ability to fix the facility and bring it into line with the performance of its other facilities.

In order to understand more fully how environmental performance plays a role in acquisitions, my co-authors and I held informal interviews with managers and performed an archival search for discussion of these issues. A more thorough discussion of our findings is available in Appendix A of our paper.

What we have found is that relative environmental performance between acquirers and targets matters for acquisition. Firms with stronger environmental capabilities tend to buy targets with weaker ones and vice versa. We claim that, beside cleaning or operational costs, a transfer of environmental capabilities could explain certain acquisitions.

Such transfers are strengthened by the proximity between the acquirer and the target; a purchase, if properly executed, efficiently integrated and subsequently well managed, should enable the transfer of the environmental capabilities that are embedded in the target into the purchaser. I call this a green target to brown acquirer transfer. Likewise, they can move in the opposite direction in a green acquirer to brown target transfer. We see green to brown transfers in cases where companies that possess well-developed environmental capabilities buy companies that lack them.

Interestingly, our findings imply that the (hypothesized) transfer of environmental capabilities increases its diffusion within the industry making it "greener".

I believe, then, that green considerations have a much more significant impact today, at a higher level within the corporate management hierarchy, than at any time in human history. Green considerations have moved rapidly from being a superficial add-on to being an essential component in corporate life, helping to drive corporate strategy.

Implemented intelligently, and successfully, green management

can deliver production that is more efficient, reduce waste, drive down costs, and push up profitability. My research, observations and experience all combine to prompt me to make a suggestion that might merit further study because, quite literally, it can pay to be green. ■

Luca Berchicci is Associate Professor of Entrepreneurship and New Business Venturing, Department of Strategic Management and Entrepreneurship, Rotterdam School of Management, Erasmus University. His research interests focus on understanding how managers develop and make use of firm's capabilities to achieve greater performance. He also studies how firms acquire capabilities that allow them to improve their performance relative to new criteria. EMAIL lberchicci@rsm.nl

Environmental Capabilities and Corporate Strategy: Exploring Acquisitions Among US Manufacturing Firms (August 24, 2011) is written by Luca Berchicci, Glen Dowell and Andrew A. King – Johnson School Research Paper Series No. 33-2011. It is available at SSRN: http://ssrn.com/abstract=1916306