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International regulatory turbulence: strategies for success

by Frank Wijen and Rob van Tulder

Managing organisational politics for effective knowledge processes

by Jatinder S. Sidhu, Shahzad M. Ansari, Henk W. Volberda and Ilan Oshri

The rewards of corporate giving

By Lonneke Roza, Lucas Meijs and Peeter Verlegh

Embodied myopia and purchasing behaviour

by Bram Van den Bergh, Julien Schmitt and Luk Warlop

The business school that thinks and lives in the future

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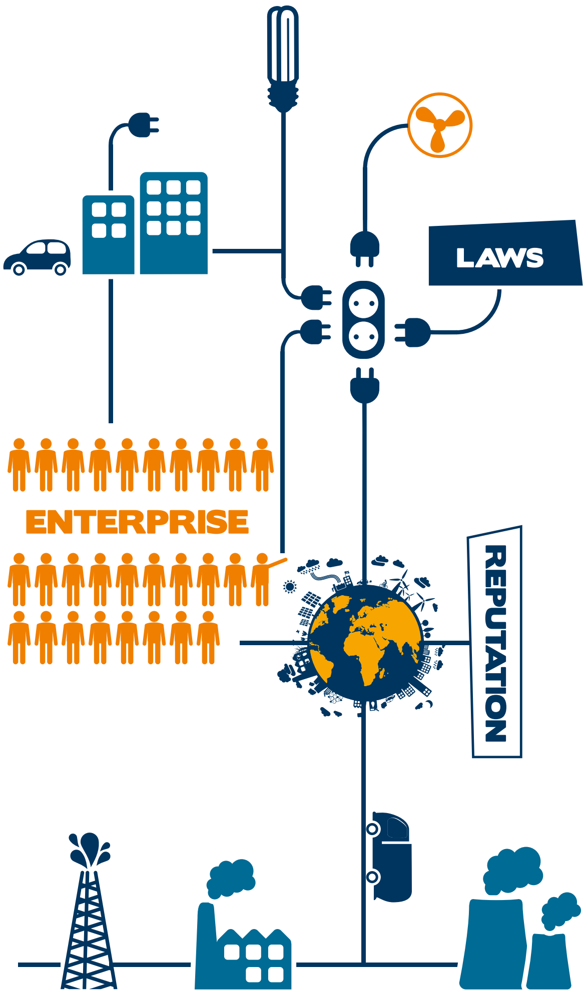
Multinational enterprises face a great variance of environmental regulations in the countries in which they operate. How best to confront this challenge? In our research, we set out to develop and illustrate a conceptual framework for understanding the problem and suggest appropriate strategies.



Multinational enterprises (MNEs) operate in a host of different countries, each of which has its own set of environmental regulations. As a result, they are inclined to structure their operations differently from one country to the next. The more variance there is, the greater the challenge to not only comply with these regulations, but also to benefit from firm-specific advantages – such as superior technology or marketing skills – across these countries. However, what is the best approach?

To capture the variety of regulations companies face, we developed the concept of *regulatory turbulence*. It has two dimensions: the stringency of environmental regulations and the fluctuation in these rules and regulations over time. In one corner of the matrix are countries like Germany, where environmental regulations are relatively strict and there is little fluctuation over time. In the opposite corner are countries like Nigeria, which are more lenient. In countries with lenient regulatory regimes, the likelihood of fluctuation tends to be relatively high (there are notable exceptions, such as China). In any case, stringency can go both ways: rules may be relaxed, but they can also be made stricter.

So how should MNEs operating in both strict and lenient countries deal with this situation? One extreme is to go completely local, adapting each subsidiary to local circumstances. The other extreme is to establish one single, standardised way of operating across the entire organisation. In our analysis, the direction an organisation takes depends not only on regulatory turbulence but also on *market interdependence*.

As globalisation evolves, MNEs are increasingly turning to global supply chains. That means activities are split across various countries, whereby vertical specialisations are developed. For example, components manufactured in China may be assembled in Mexico and then shipped to the USA for final production. By distributing operations in this way, significant market interdependence is created across the supply chain.

Workers in Mexico cannot assemble the products unless the components meet specifications exactly. This kind of standardisation means the whole supply chain becomes deeply interconnected.

If there are any changes to operations in one country, they directly affect operations elsewhere. This is one important source of interdependence.

Another source of interdependence relates to regulation. Some companies trade on their brand image and corporate reputation. Thanks to new communication technologies, news travels very quickly. Thirty years ago, news of damaging incidents may have remained local. Today that is no longer the case. While an organisation responsible for an oil spill in Nigeria may not be condemned in court, news of the incident will spread around the world in a matter of hours. The point here is that an MNE may have many operations in different locations and each one of them can impact its image worldwide. Therefore, reputation is another source of interdependence.

If reputation is a source of competitive advantage, MNEs need to be careful not to damage it. Environmental groups keep a close eye on prominent MNEs and any slip-up will attract potentially reputation-damaging attention. So, although it may be tempting to take advantage of lenient regulatory regimes, it is more prudent to go beyond the minimum required and not run the risk of being labelled a "dirty company". Once an MNE has suffered damage to its reputation, it inevitably takes proactive measures to avoid repetition in the future. However, smart MNEs take measures to ensure that such incidents will not happen.

Is it difficult to make an economic case for voluntarily adopting stricter environmental measures? It depends. The more immediate short-term shareholder pressure an organisation faces and the more the management mindset is in a rut, the more likely companies are to stick to whatever they were doing. Taking a long-term view may require managers to revise corporate routines. While this is challenging, and could damage short-term performance, there are plenty of reasons why MNEs may want to improve current procedures.

It is important to realise that there are often hidden opportunities in every challenge. For example, a proactive company may be able to squeeze more out of the natural resources it uses if it finds that pollution is a source of inefficiency. Companies tend to perpetuate their existing practices as long as they have no reason to change them. However, it is a smart strategy to consider and benefit from hypothetical situations.

For example, imagine a government suddenly tightened up its regulatory standards. As a manager, what would you do if present emissions had to be cut by 50 per cent? How would production processes change to meet this? It could be a difficult challenge, requiring some major adjustments to processes. However, if an MNE takes the measures needed to succeed, even in the absence of actual regulatory pressure, not only would emissions be lower, but resource efficiency would be improved and profitability boosted.

It is important to consider relevant contingencies. Does the company have a high or low degree of market interdependence? If high, the company is better off using standardised environmental practices. In what kind of countries does it operate? If there is significant regulatory turbulence, then an MNE should tighten its standards or "localise" practices in countries with highly divergent environmental regimes.

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International regulatory turbulence:
strategies for success (continued)

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It is important to think ahead. Smart management is forward-thinking management. Many businesses tend to focus only on the present. Obviously, short-term survival is important, but it is always better to look beyond the immediate horizon and try to anticipate developments. Even in countries with lenient regulations, scenarios change quite rapidly. Practices tolerated only two or three years ago are being prohibited. As an example, China used to be a country where an enterprise could do nearly anything as long as it contributed to the local economy, but that is changing and what is permissible today might not be tolerated tomorrow.

"Smart multinationals look beyond the issues of the day and embed environmental strategy into their international competitive strategy."

Situations can change rapidly and move from one extreme to another. If changes to environmental regulations cannot be forecast, it is better for MNEs to err on the side of caution. That means implementing relatively strict standards, rather than being on the lenient side, and risk exclusion from certain markets. In many sectors, environmental measures do not have a large impact on cost prices. Indeed, whilst this may not be true in the chemicals, steel, and pulp and paper industries, for many others environmentally relevant measures represent only a fraction of the total cost price. Moreover, there is a growing business case for clean production.

If taking proactive environmental measures does not affect an MNE's competitive position, then it is advantageous to do so since there is no direct downside. Adopting a tone of 'we would love to but can't without undermining our competitive position' is typically a spurious argument. Expenditure on such measures may only represent a few per cent of the total cost price and the payoff – whether in terms of society legitimacy, employee morale, or access to markets – may be quite considerable. Therefore, MNEs should consider the whole picture, not just direct out-of-pocket expenses.

Many companies focus on financial costs and do not consider the eventual benefits of taking a proactive stance in relation to environmental considerations. However, smart multinationals look beyond the issues of the day. Instead, they embed environmental strategy into their international competitive strategy and consequently are able to pilot their way safely through regulatory turbulence. ■

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