



Understanding business decision making on the environment [☆]

Andy Gouldson ^{*}

Sustainability Research Institute, University of Leeds, West Yorks, Leeds LS2 9JT, UK

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ABSTRACT

This paper considers the influence of a range of factors within and around the firm on business decision making relating to the environment. Within the firm, it emphasises the importance of governance structures, corporate cultures and organisational capacities. Around the firm, it stresses the importance of the incentives, imperatives and informational pressures that emerge from governments, markets and civil society. It is argued that change is most likely where the various external pressures resonate with each other, and where they impact upon firms with receptive corporate cultures and adequate organisational capacities. It is also argued that these preconditions for change are often absent, which makes change more difficult or more expensive. It is further argued that even when these preconditions are in place, they are likely to engender only to incremental change. As prolonged periods of incremental change must eventually encounter diminishing returns, the key challenge for those seeking to promote significant changes in business behaviour is to put in place the full range of conditions needed to allow companies to make them. This can mean focusing not only on the operational but also on the strategic activities of businesses, and not only on individual businesses but also on the broader systems and networks within which they operate.

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1. Introduction

Mainstream debates on business and the environment emerged in a meaningful way only in the early 1990s. These debates focused initially on the scope for different forms of technological and organisational change to improve the environmental performance of businesses. More recently, debate has moved beyond a primary focus on the environment to consider broader issues of sustainability and corporate responsibility. Contemporary debates focus not only on procedures but also on outcomes, not only on production but also on consumption, and not only on individual businesses but also on the systems within which they operate.

Debates on business and the environment have considered two types of influence on organisations: the external pressures on businesses that stem from governments, markets and civil society, and the internal conditions within businesses that relate to their governance structures, corporate cultures and capacities for innovation. It is now widely accepted that the interaction between these external and internal factors shapes the context for business decision making. But it is clear that this behaviour is also shaped

by the scope for change, and particularly by whether businesses can only change incrementally within the constraints of existing structures and systems, or whether they are able to innovate more radically by reinventing their business models and practices. The discussion that follows examines each of these aspects in turn.

2. External pressures

The range of policy instruments that governments have adopted to correct market failures (classically the under-provision of public goods, or the over-exploitation of common resources) and to shape business behaviour has extended dramatically in many contexts in the past 10–15 years. Regulations now regularly sit alongside economic and information-based instruments and voluntary approaches. Understanding of how to design and deliver these instruments has evolved rapidly:

- On command and control regulation, there has been considerable research on what might constitute innovation-friendly regulation (Fiorino, 1999; Porter and van der Linde, 1995), and on how to deliver better regulation to reduce business burdens (Gouldson, 2007).
- On economic instruments, there has been much research on the prospects for eco-tax reform and its possible influence (Bosquet, 2000), and understanding on emissions trading has developed rapidly (Gagelmann and Frondel, 2005).

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^{*} Tel.: +44 113 343 6417.

E-mail address: a.gouldson@see.leeds.ac.uk

- On information-based approaches such as eco-labels and pollution inventories, it is increasingly accepted that governments can play a critically important role in providing reliable information and thus in enabling economic or civic actors to influence business behaviour (Gouldson, 2004; Hamilton, 2005).
- On negotiated agreements and voluntary approaches, we now have a fuller understanding of how to structure agreements and on the conditions under which such approaches can deliver real improvements in environmental performance (Hansen et al., 2002; ten Brink, 2002).

Despite these advances in understanding, these instruments are rarely designed to interact fully within a 'complementary policy mix' (OECD, 2007; Sorrell and Sijm, 2003). Despite a certain amount of work on environmental policy integration (Lenschow, 2002), policy signals from areas such as trade and industry, energy, transport and agriculture often continue to contradict the signals that explicitly environmental policies send to business. This absence of integrated approaches can be regarded as a form of what has been termed state or government failure (Dixit, 2006; Janicke, 1990).

Discussions on the influence of government on the environmental performance of business increasingly acknowledge the limited capacities of the state to regulate and steer technological change and economic development (Berkhout and Gouldson, 2003). Discussions have shifted away from a reliance on state-centred forms of government intervention and towards an emphasis on decentred forms of governance where the state works with market and civic actors to achieve public interest objectives (Black, 2002). Such changes are often associated with a transition from the controller state towards the facilitator or enabler state (Gouldson and Bebbington, 2007).

With regard to the role of market actors, it is now recognised that investors can play an important role (Sullivan and Mackenzie, 2006), that business-to-business initiatives (perhaps through supply chains) can be a significant influence on business behaviour (Hall, 2000), and that end consumers can be significant drivers of change in some (possibly niche) markets (Peattie, 2002). We also know that civic actors such as pressure groups and local communities can be a significant influence on business behaviour and that their influence can be enabled by government and amplified by the media.

3. Internal conditions

It is widely accepted that the potential for greening a firm can be shaped by its corporate governance structures, corporate cultures and organisational capacities.

In corporate governance, a key issue is the influence of different forms of ownership on the environmental performance of firms. The evidence on relations between environmental performance and competitiveness is still quite mixed (Wagner, 2001). Many mainstream investors continue to be reluctant to support investments in environmental improvement that have uncertain, intangible or only longer-term benefits, and which may have significant opportunity costs. While it may be simpler for an owner-managed firm to be driven by the personal values of the owners, competitive realities limit the extent to which such firms can invest in improved environmental performance. This means that government policies are critically important in creating a climate where investments in environmental improvement can be made without undermining competitiveness. This can lead to a tendency for the public rather than the private sector to invest in environmental protection. Initiatives that seek to apply the

'polluter pays' principle, for example using permits or liability schemes, can limit this risk.

Corporate cultures also exert a defining influence on the context for business decision making on the environment (Nwachukwu and Vitell, 1997). Cultural factors can be difficult to define. At their simplest they reflect issues such as whether a business and the people within it perceive an issue as a threat or an opportunity, and whether they are short-termist, with an aversity to risk, or more strategic, with an ability to manage risk. While it is clear that such cultural factors shape business perceptions and strategies, there is little research on the relevance of this theme for business strategies on the environment.

If corporate cultures shape business perceptions and strategies, organisational capacities play a significant role in determining how businesses respond to environmental and other pressures. Much work in this area has considered the influence of management systems on businesses' capacities for environmental improvement (Dahlström et al., 2003). Research on this topic has long recognised that, while the presence of an environmental management system represents some capacity to act, the development and use of this capacity depend on internal cultures and on the range of external pressures facing the firm. For larger firms, environmental management systems may be a necessary but not sufficient condition for incremental improvements in environmental performance. But unless management systems influence strategic as well as operational decision making, they may not build capacity for more radical improvements in performance (Gouldson, 2005; Murphy and Gouldson, 2000). For smaller firms, where activities can be more easily coordinated and performance more readily monitored, management systems may add an unnecessary layer of bureaucracy, which constrains entrepreneurial activity and undermines competitive advantage (Hillary, 2004). The factors that shape the environmental performance of smaller firms remain under-researched and poorly understood.

4. The scope for change

The research which is summarised above suggests that improvements in the environmental performance of business are most likely where the external pressures resonate with each other and where they impact upon firms with receptive cultures and adequate capacities. These conditions for change are often absent. Businesses face a range of competing and often contradictory signals from governments, markets and stakeholders. Even where a clear need for change is established, businesses often lack the capacities to respond, particularly where they are locked into existing structures, systems and technological trajectories (Porter and van der Linde, 1995).

Where the conditions for change are in place, much of the change that results tends to be incremental. There is some evidence that businesses with appropriate cultures and capacities can make incremental changes to improve environmental performance at low cost and risk, and that they learn from doing so. This allows them to build their capacity to make further changes (Murphy and Gouldson, 2000). However, there is a broader consensus that businesses that pursue only incremental changes must eventually encounter diminishing returns (Freeman, 1992). Once this point is reached, more radical changes are needed to open up new possibilities and to create the potential for further periods of incremental change. This suggests that policy interventions are needed that stimulate both incremental improvements in day-to-day operations and radical changes in longer-term business strategies.

There has been comparatively little research on how government policies can create the potential for radical changes in the

environmental performance of most businesses. In recent years, a new literature has emerged that focuses not on individual businesses but on the broader systems and networks within which they operate (Foxon et al., 2005). It emphasises the potential for socio-technical transitions to deliver radical improvements in the environmental performance of the economy (Kern and Smith, 2007). This broader approach calls for the introduction of more coordinated and innovation-friendly policy frameworks than those that are commonly in place today. As these broader systems and networks tend to span national boundaries, the introduction of such a policy framework is also likely to depend on coordination between firms and between governments.

5. Conclusions: key advances and key challenges

Our understanding of the factors that influence business decision making on the environment has developed rapidly in recent years. Key advances have related to the influence of different policy instruments, the growing importance of new forms of non-state regulation from market and civic actors, and the ways in which the influence of this range of external factors is conditioned by the structures, cultures and capacities that exist within firms. They have also related to the significance of technological lock-in, the importance of the relationship between incremental and radical change, and the potential for systems change through transitions management.

One key set of challenges for the future relates to the ability of government to pursue integrated approaches that coordinate interventions from different policy domains, and to adopt a complementary, innovation-friendly mix of policy instruments. Others relate to the ability of state and non-state actors to influence small business behaviour, to shape strategic as well as operational decision making in larger firms, and to promote radical as well as incremental forms of change. There are also significant questions about the ability of governments to influence the sustainability of economic development, particularly in globalised markets where there is a need for coordinated interventions that cross national boundaries.

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