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Abstract

Close relationships between firms and governments will impact a firm's environmental performance through different channels. In particular, politically embedded firms are less exposed to direct coercive pressure, but face higher normative and mimetic pressures to engage in environmental management. In this short paper we expand on the results of Nguyen, et. al. (2021) to discuss these different channels and extrapolate the likely effect of closer ties with the government created during the COVID-19 crisis for the environment.

Keywords: political embeddedness, government contracts, ESG, CSR, environment, competition

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Introduction

Governments are generally becoming more important as part of the economy. This is not only due to the rise of countries where the government traditionally has a strong influence on businesses such as China and Vietnam. Even in western countries the role of government has slowly expanded over the last century. This expansion is likely to see a massive acceleration in the aftermath of the COVID-19 crisis, with the US and European governments spending large amounts of money on post-crisis stimulation.

Whether the increased role of government is good or bad news for the environment is not obvious at first sight. On the one hand, governments are of course supposed to protect the common good and rein in on externalities, such as pollution. Following this argument, we would expect a stronger role for government would also lead to better environmental performance. On the other hand, however, there is a common perception that companies with strong ties to governments are sometimes allowed to bend the rules. This is particularly relevant for transition countries where the government often owns stakes in mature industries that over-pollute, which with stringent implementation of environmental standards would no longer be viable.

Literature Review

In management literature authors such as Haveman et al., 2017; Okhmatovskiy, 2010; Wang et al., 2018 have presented evidence showing that firms with close government ties have better environmental management practices. According to this literature politically embedded firms are highly monitored and governments will intervene in their governance. Hence, they are more likely to respond to coercive pressure imposed by regulatory bodies (Marquis & Qian, 2014).

The opposite view is taken by legitimacy theory which posits that politically embedded firms are legitimate by default and thus have less need to perform well in CSR or environmental issues. In other words, political connections protect firms from regulation. This literature argues that it is rather non-connected firms that need CSR activities to enhance their legitimacy, create goodwill with the government and gain access to resources (Lin et al., 2015; Marquis & Qian, 2014; Zhao, 2012). Consistent with this theory, it can be shown that state-owned or partially state-owned firms are able to circumvent environmental regulations and exhibit worse environmental performance that private firms (Eaton & Kostka, 2017; Li & Chan, 2016).

Obviously, both of these theories capture some aspects of the reality: several channels exist though which links to the government can impact on environmental management practices. Scott (2013) proposes the following typology for institutional influence: coercive, normative, and mimetic pressure. Coercive pressure is imposed by the government in the form of regulations (Anton, Deltas, & Khanna, 2004; Lefebvre, Lefebvre, & Talbot, 2003). Normative pressure comes from social or professional obligations, which encourage firms to act beyond regulatory compliance to be legitimate in the eyes of external stakeholders (Hoffman, 1999; Sarkis, Zhu, & Lai, 2011; Zhu & Geng, 2013). Mimetic pressure comes from peers in the field, who engage in environmental management practices beyond regulatory compliance and induce others to imitate them in order to gain legitimacy or remain competitive (Phan & Baird, 2015).

Political Embeddedness and Environmental Performance

The government is a powerful stakeholder who can significantly change all three types of pressures listed above, especially when it has a close relationship with the firm. In Nguyen, et. al. (2021) we refer to these relationships as the political embeddedness of the firm. Similar to previous literature, we measure political embeddedness by state ownership, or the political connections of managers (Haveman, Jia, Shi, & Wang, 2017; Marquis & Qian, 2014; Okhmatovskiy, 2010), but also introduce a third new proxy, namely the presence of government contracts.

We have used a large database collected by the World Bank to carry out a detailed analysis of whether political embeddedness has a positive or negative influence on environmental management practices. We measure the different types of institutional pressures and then verify which one of these influence channels is more relevant for firms with close ties to the government. Specifically, we proxy for coercive pressure by the percentage of total senior management's time spent on dealing with requirements imposed by government regulations. Normative pressure is captured by environmental concerns of the firm's customer. Finally, mimetic pressure is measured by a firm's membership in business associations.

Overall, we obtain an encouraging message: If we simply compare politically embedded firms with similar non-embedded firms, we see that politically embedded firm perform better in almost all dimensions of environmental management practices. For example, we find that politically embedded firms are more likely to include environmental issues in their strategic objectives, and assign a manager responsible for environmental issues. Moreover, they are more likely to adopt environmentally friendly planning and operational practices such as monitoring and managing resource consumption and emissions.

However, a closer look at the different channels through which embeddedness influences environmental performance produces more balanced results: We can show that consistent with legitimacy theory, political embeddedness can indeed shield firms from environmental regulations, resulting in a negative effect on the adoption of environmental management practices. This negative effect is, however, weak, and is compensated by higher normative and mimetic pressures for politically embedded firms. Moreover, firms with state ownership and political connected managers, are under much higher mimetic pressures while firms with government contracts have higher normative pressure to go green. Therefore, overall, the positive effects dominate. In other words, political embeddedness generally improves environmental management.

Firms Become More Proactive

These results are in line with Anton et al. (2004) who observe that firms' management strategies have shifted from regulation-driven to proactive, voluntary approaches. They explain that this change is due to the fact that environmental policy is becoming more dependent on market-based incentives, but our results show that this mechanism also extends to government influence. Politically embedded firms proactively adopt environmental practices not because they are coerced, but more due to normative and mimetic pressures.

Using our data, we can also analyze the interaction between market and government influence: while firms operating in more competitive markets are under strong normative and mimetic pressures, monopolistic firms are under significantly lower normative pressure to adopt environmentally friendly practices. For these firms, only pressure from the government can make them more environmentally friendly. These results illustrate the importance of governments when normative and mimetic pressures are low.

Conclusion

Regulation can reduce environmental externalities, but relying exclusively on firms' reactions to regulation will not be sufficient to solve the world's increasing environmental problems. Firms will also need to proactively adopt pro-environmental practices. Our results show that normative and mimetic pressure play the most important role in improving environmental management practices in firms around the world. So our results bode well for a future where there likely will be more government influence on the economy. A more important role for government may well reduce coercive pressure, but will increase those indirect influences which have a more important impact on overall environmental performance.

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