Increase incentives, decrease corporate pollution

Manufacturers: Don’t skimp on marketing or R&D to stay on top

You say illegal, I say legitimate

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In the name of the company
Increase incentives, decrease corporate pollution

Two things can dramatically decrease the level of pollution likely to be created by a firm, says new research. No, it's not complicated machinery for carbon sequestration, or more government regulation. It's much simpler: family ownership and financial rewards.

New research suggests that firms where a single family owns at least five percent of the voting stock, pollution levels are much lower. Also, firms pollute less when the CEO is given long-term financial incentives for pollution control.

To come to these results, researchers analyzed toxic emission reports from the Environmental Protection Agency, examining the structure and actions of hundreds of companies.

When it comes to family ownership, researchers hypothesize that when a family's image and reputation are at stake, there is a greater drive to be ecologically sound. Institutional investors tend to have a more short-term view of the business, while family owners are more concerned with its overall quality and longevity, says Luis Gomez-Mejia, the Benton Cocusougher Chair in Business and Mays management professor, who has co-authored two studies on the topic of corporate pollution reduction.

Other research on family-owned firms and "socio-emotional wealth" dovetails with Gomez-Mejia's: leaders of family-owned companies are more likely to derive a sense of identity from the firm, desire to be seen as generous and pro-social within a community, and strive to maintain group integrity within a community.

These factors create a non-economic incentive for environmental efficacy, particularly if the family and the business are concentrated in one location, as the family usually cannot escape being the face of the business.

When firms are not family owned, Gomez-Mejia says corporate pollution reduction is still a matter of incentives; however, this time the incentive is financial rather than socio-emotional. "To the extent that the CEO is rewarded for investing in pollution control and also pollution prevention, the more likely it is that the firm will engage in those efforts," he says.

Furthermore, the structure of the incentives matter: stock and option incentives are more effective than cash in pollution reduction. This is due to the long-term nature of both meaningful environmental policies and the interest-bearing securities. That is, continued pollution control leads to continued corporate wellbeing, which leads to continued growth of securities held by the CEO.

Gomez-Mejia admits there is one limitation to the research: the EPA only requires emission reports for American companies and many of the corporations involved in the study are multinational. "A remaining question is to what extent...the CEOs may have an incentive to move or shift the pollution elsewhere," he says. He is planning a follow-up study to investigate this question, but notes that data collection is difficult, as pollution reporting in many developing countries is not accurate.

For more information, contact Gomez-Mejia at lgomez-mejia@mays.tamu.edu.

"Socio-economic wealth and corporate responses to institutional pressures: Do family-controlled firms pollute less?" is a collaboration between Pascual Berroa, Cristina Cruz, Gomez-Mejia, and Martin Laraza-Kintana, published in Administrative Science Quarterly in 2010.


Point your smartphone here to see a short video of Gomez-Mejia discussing this research.
Manufacturers: Don't skimp on marketing or R&D if you want to stay on top

Even during a time of recession and cutbacks, manufacturing firms must continue to invest in marketing and R&D if they want to remain successful, says a new study from Texas A&M University.

Researchers examined manufacturing firms on the Fortune 500 list for a period of 25 years, weighing a variety of firm and industry specific factors to arrive at their conclusion. They found that investing capital in both marketing and research and development have a direct positive effect on a manufacturing firm's survival as a member of the elite Fortune 500 list—firms that account for nearly three-fourths of the U.S. GDP.

In fact, they found that if a Fortune 500 manufacturing firm were to incrementally spend one percent of its average sales revenues on marketing and another one percent on R&D for five years, that investment would reduce the firm's risk of leaving the list by 27.8 percent.

This is significant, says researcher Venkatesh Shankar, Coleman Chair in Marketing at Mays, as “the firms that stay on the Fortune 500 list enjoy a lot of benefits,” such as lower cost of capital and increased reputation and brand equity. Fortune 500 firms also see increases in their share prices specifically associated with their entry into this list.

Alternately, a fall from the list can be a precursor to negative events, like bankruptcy and hostile takeover.

Using this investment strategy can “significantly decrease the hazard of exiting the Fortune 500,” says Shankar. This strategy would also apply to companies that aspire to be on the list.

“These firms pour billions of dollars into R&D and marketing, yet no study has examined this important issue in depth,” say researchers. “The findings are important not just for marketers, but for senior executives in manufacturing, operations, innovation management, and top management as well.”

Not all firms benefit equally by the two areas of investment, however. Firms that are in high growth industries, such as technology, see a greater impact from marketing investment. Firms in slow growing or mature industries, such as cosmetics or packaged food, see greater returns from investment in R&D. Similarly, in any industry during periods of high growth, investing marketing capital is more effective and in times of low growth, investing R&D capital is more effective.

Shankar says that these findings broadcast an important message for managers: view marketing and R&D not as expenses, but rather long-term investments that need to be employed strategically in industries and periods of high and low growth. Many firms are cutting back in these areas to boost short-term profitability during a rocky economic period, he says. “And that can be very dangerous, because while…they may see immediate results, over the long run it could be detrimental.”

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The research was conducted by Shankar and colleagues Gautham Gopal Vadakkumpatti, a recent graduate of the Mays PhD program, and Rajan Varadarajan, department head, Distinguished Professor of Marketing, and Ford Chair in Marketing & E-Commerce. Their paper, “A study of the factors affecting the survival of manufacturing firms in Fortune 500: The asymmetric roles of marketing capital and R&D capital,” was published by the Marketing Science Institute in 2010.

Point your smart phone here to see a short video of Shankar discussing this research.
You say illegal, I say legitimate

BOOTLEGGED CONCERT RECORDINGS, undocumented immigrants building houses in the U.S., New York City street vendors selling designer knock-offs—these are examples of a largely unexamined economic activity, the "informal economy." These economic activities are considered illegal yet are still viewed as socially acceptable or legitimate by some substantial segment of society.

Because nearly nine percent of the GDP of the United States (and perhaps more than 60 percent in some African and South American countries) is involved in the informal economy, it is a topic worth exploring, says Duane Ireland, Distinguished Professor of Management and Conn Chair in New Ventures Leadership. He and two Mays colleagues, David Sirmon and Laszlo Tihanyi, and Justin Webb, a recent graduate of the Mays PhD program who is now at Oklahoma State University, have examined how the informal economy works and the reasons some ventures thrive, despite barriers of legality and legitimacy.

The cornerstone of their research is a matrix for categorizing entrepreneurial activities based upon legality and legitimacy. While some entrepreneurial activities in the informal economy are considered illegal yet legitimate (e.g., the sale of counterfeit products or use of undocumented workers as labor to build a home), other entrepreneurial activities fall into different classifications of legality and legitimacy. For example, tobacco-based and adult-oriented products in the United States are legal yet considered illegitimate by large societal groups.

In contrast, illegal drugs and human trafficking are considered illegitimate by the overarching society. Distinguishing among different classifications of legality and legitimacy is important to understanding the mechanisms through which these entrepreneurial activities are able to exist, grow, and be sustained even while occurring outside of the law.

Ireland says one aspect that he finds fascinating is how a business can move between categories over time, due to the intentional actions of the business or due to shifts in the definitions of legality and legitimacy. Take for instance, alcohol sales in the United States in the 1920s during prohibition. Though it was illegal, speakeasies and bootlegged liquor became quite commonplace and legitimate. Then in 1933, the industry once again was legalized. This is a great example of the fluid nature of the boundaries in this area.

In a similar vein, the production of marijuana is an example of the porous nature of the matrix, as it is moving from illegal and illegitimate in the United States to illegal but legitimate, or legal but illegitimate, depending on some groups' norms, values, and beliefs and various state and local laws.

Another example is Napster and Youtube.com during initial operations. It was alleged that Napster allowed users to violate copyright laws by sharing audio files freely. The online service was hugely successful from 1999 to 2001 when it was shut down due to issues of legality. At least initially, similar allegations suggest that Youtube violated copyright laws by not removing items from its site that were posted by individuals who did not have permission from the owners of the postings. However, for some large companies and with an increasing expectation of free content on the Internet, Youtube is still seen as legitimate, despite the fact that some postings may not be legal with respect to copyright laws.

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The paper "You say illegal, I say legitimate: entrepreneurship in the informal economy," appeared in Academy of Management Review in 2009 and was a finalist for best paper that year.
Close company: Did Sarbanes-Oxley get it wrong?

Toward the end of their relationship, Enron was paying nearly $50 million each year to Arthur Andersen for services, including both internal and external audit functions. Did the risk of losing such a large client lead to the ethical compromises that Andersen was willing to make in colluding in the enormous fraud scandal that eventually brought down both firms?

Yes, said analysts, who recommended internal and external audit functions in public companies be split between firms to prevent economic bonding and cooperation in fraud. Created soon after, the Sarbanes-Oxley Act prohibited external audit firms of public companies from having any involvement in the internal audit function.

However, research from Nathan Sharp, assistant professor of accounting, suggests this move may have been a mistake.

Sharp and colleagues investigated companies in the pre-SOX era to determine if companies that outsourced or co-sourced internal audit work to their external auditor had a higher risk of misleading or fraudulent external financial reporting. The result? This relationship actually lowered accounting risk.

The reason is simple. When a single firm is involved in both audits, it’s harder for fraud to go undetected, as there is greater communication between both audit teams. Knowledge spillover occurs because the internal audit team provides insights into the company that an external audit team might miss. This information sharing is less likely to happen when the teams are from competing firms or when the internal audit function is kept entirely in-house.

There is much debate about this topic says Sharp, and he and his colleagues are not suggesting SOX be changed. However, if you talk to public accounting firms, the opinions are clear: It’s good sense to make it easier to share information between internal and external audit teams to create the most complete financial snapshot of a company.

When a single firm is involved in both audits, it’s harder for fraud to go undetected, as there is greater communication between both audit teams.

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Sharp’s article, “Internal Audit Outsourcing and the Risk of Misleading or Fraudulent Financial Reporting: Did Sarbanes-Oxley Get It Wrong?” coauthored with Doug Prawitt and David Wood, is currently under review at Contemporary Accounting Research.
In the name of the company

When you hear of corporate scandals, you might assume that the perpetrators of the crime were acting out of self-interest—that they cooked the books or covered up information to get rich or move up the corporate ladder. But what if there was another motive that has nothing to do with personal gain?

A recent study from Elizabeth Umphress, associate professor of management and Mays research fellow, looks at motivations for unethical behavior that benefits the corporation (called “unethical pro-organizational behavior,” or UPB) and how it may be tied to the degree of organizational identification the individual feels.

The researchers define UPB as activity that is not specified by formal job descriptions; is either illegal or morally unacceptable to the larger community; and includes acts of commission (e.g., cooking numbers to boost analyst projections and stock values) and omission (e.g., withholding information about the hazards of a pharmaceutical product).

In three studies Umphress and colleagues conducted, the results were consistent: there was not a direct relationship between organizational identification and UPB. However, there was a relationship between the two if a third element, positive reciprocity, was involved.

Findings indicate that if an individual feels a need to reciprocate when something has been done for them, and also strongly identifies with the organization, then they are more likely to commit UPB. Employees who strongly identify with their organization feel obligated to protect and maintain their membership in the organization.

They also find that people can be primed to commit UPBs—when they showed a test group a video that enhanced their feeling of organizational identification, they were more likely to agree to UPBs (if they scored highly on measures of positive reciprocity) than those who had seen an unrelated video.

Both organizational identification and positive reciprocity are good traits for an employee to possess, says Umphress. They can make an employee more diligent, productive and loyal. Managers need to be aware, however, that they can interact in this negative way. Umphress stressed that hiring decisions need not be made on this criteria, but that managers should be aware of the degree of these traits in their employees and understand that in the right circumstance “the employee might feel compelled or feel that it’s their duty to do something unethical…to help protect the organization.”

In previous literature, researchers have focused predominately not on unethical behavior that boosted the organization, but rather behavior that harms it, such as stealing or sabotage. This study is one of the first to examine this unique relationship.

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Umphress’s article, “Unethical behavior in the name of the company: the moderating effect of organizational identification and positive reciprocity beliefs on unethical pro-organizational behavior,” written with coauthors Marie Mitchell and John Bingham, appeared in Journal of Applied Psychology in 2010.

Point your smartphone here to see a short video of Umphress discussing this research.