

## Law, Strategy and Competitive Advantage

By:

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Firms continuously seek a competitive advantage over rivals.<sup>1</sup> Identifying sources of competitive advantage has long interested strategy theorists.<sup>2</sup> Scholars have identified competitive advantage opportunities in most business-related disciplines, including marketing,<sup>3</sup> accounting,<sup>4</sup> human resources,<sup>5</sup> and management.<sup>6</sup> Scholars have also studied competitive advantage from cross-functional perspectives such as organizational capital,<sup>7</sup> human capital,<sup>8</sup> and global competition.<sup>9</sup> The result has been a voluminous literature improving firm strategy.

In spite of these efforts, the notion that law may be a source of competitive advantage remains largely unexplored.<sup>10</sup> This is especially noteworthy given that legal issues may

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<sup>1</sup> James W. Busbin, Julie T. Johnson, & James DeConinck, *The Evolution of Sustainable Competitive Advantage: From Value Chain to Modular Outsource Networking*, 6 *COMPETITION F.* 103, 104 (2008).

<sup>2</sup> See, e.g., David J. Teece et al., *Dynamic Capabilities and Strategic Management*, 18 *STRAT. MGMT. J.* 509, 509 (2006) (“The fundamental question in the field of strategic management is how firms achieve and sustain competitive advantage.”); Jay Barney, *Firm Resources and Sustained Competitive Advantage*, 17 *J. MGMT.* 99, 99 (1991) (“Understanding sources of sustained competitive advantage for firms has become a major area of research in the field of strategic management.”).

<sup>3</sup> Sundar G. Bharadwaj et al., *Sustainable Competitive Advantage in Service Industries: A Conceptual Model of Research Propositions*, 57 *J. MARKETING* 83 (1993).

<sup>4</sup> Alan S. Dunk, *Product Life Cycle Cost Analysis: The Impact of Customer Profiling, Competitive Advantage, and Quality of IS Information*, 15 *MGMT. ACCT. RES.* 401 (2004).

<sup>5</sup> Sugio Baba, *Remodelling Employment for Competitive Advantage: What Will Follow Japan’s “Lifetime Employment”?*, 3 *ASIAN BUS. & MGMT.* 221 (2004); Augustine A. Lado & Mary C. Wilson, *Human Resource Systems and Sustained Competitive Advantage: A Competency-Based Perspective*, 19 *ACAD. MGMT. REV.* 699 (1994).

<sup>6</sup> Riccardo Silvi & Suresh Cuganesan, *Investigating the Management of Knowledge for Competitive Advantage: A Strategic Cost Management Perspective*, 7 *J. INTELL. CAP.* 309 (2006).

<sup>7</sup> Gregorio Martín-de-Castro et al., *Organizational Capital as Competitive Advantage of the Firm*, 7 *J. INTELL. CAP.* 324 (2006).

<sup>8</sup> Nile W. Hatch & Jeffrey H. Dyer, *Human Capital and Learning as a Source of Sustainable Competitive Advantage*, 25 *STRAT. MGMT. J.* 1155 (2004).

<sup>9</sup> Hao Ma, *Toward Global Competitive Advantage: Creation, Competition, Cooperation, and Co-Option*, 42 *MGMT. DECISION* 907 (2004).

<sup>10</sup> Cf. Larry Downes, *First, Empower All the Lawyers*, *HARV. BUS. REV.*, Dec. 2004, at 19, 19 (noting that “the culture of business, not to mention the cultures of law schools and business schools, will have to evolve mighty fast” to successfully exploit the value-capturing properties of the law in a business context).

require as much as twenty-five percent of a CEO's time.<sup>11</sup> According to approximately 900 surveyed business executives attending a management development program, law ranked second only to finance and human resources as a valuable discipline.<sup>12</sup> Recent demands for increased corporate regulation pursuant to the Sarbanes-Oxley Act of 2002,<sup>13</sup> the increased demand for legal compliance programs,<sup>14</sup> and the widespread use of litigation as a tool for business reform,<sup>15</sup> have increased firm's regulatory obligations. Legal issues may be one of the most important determinants in a firm's external operating environment.<sup>16</sup> Law is likely the last great source of untapped competitive advantage.<sup>17</sup>

This article bridges the divide between management and legal literature by accomplishing two goals. First, Part I this article will examine whether the legal environment can produce the most sought after type of competitive advantage – a long-term sustainable one that rivals that cannot easily imitate. After concluding that law is an abundant source of sustainable competitive advantage, Part II of this article will hypothesize variables that might encourage legally strategic thinking. If scholars can better understand the characteristics of firms and the attitudes of managers that promote legal strategy, both scholars and managers can devise ways to capture value from the legal environment that have never been previously considered. This article concludes that law and strategy research can contribute much to both disciplines and can produce beneficial insights for scholars, practitioners, and managers alike.

## I. THE CORNERSTONES OF COMPETITIVE ADVANTAGE

### A. *The Resource Based View of the Firm*

The resource-based view of the firm, which underlies this article's discussion of competitive advantage, was developed in an attempt to build a basis for understanding business policies.<sup>18</sup> At its core, the resource-based view posits that firms may obtain sustainable competitive advantage by focusing on strategies that leverage their internal

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<sup>11</sup> PAUL A. ALLEN, INTRODUCTION TO HOW TO KEEP YOUR COMPANY OUT OF COURT 12 (Paul A. Allen ed., 1984); George J. Siedel, *Six Forces and the Legal Environment of Business: The Relative Value of Business Law among Business School Core Courses*, 37 AM. BUS. L.J. 717, 729 (2000) [hereinafter Siedel, *Six Forces*].

<sup>12</sup> Siedel, *Six Forces*, *supra* note 11, at 727.

<sup>13</sup> See Stephen Wagner & Lee Dittmar, *The Unexpected Benefits of Sarbanes-Oxley*, HARV. BUS. REV., Apr. 2006, at 1, 1-2 (discussing the burdens of increased corporate regulation placed upon firms by the Sarbanes-Oxley Act of 2002).

<sup>14</sup> LYNN SHARP PAINE & CHRISTOPHER M. BRUNER, LEGAL COMPLIANCE PROGRAMS, Case. No. 9-306-014 (Harvard Business School ed., 2005).

<sup>15</sup> Wendy E. Wagner, *When All Else Fails: Regulating Risky Products Through Tort Litigation*, 95 GEO. L.J. 693, 693 (2005).

<sup>16</sup> See, e.g., GEORGE J. SIEDEL, USING THE LAW FOR COMPETITIVE ADVANTAGE 136 (2002) (noting that “[i]n a world where law touches every aspect of business operations and decision making, you need high-quality legal resources to seize competitive advantage”) [hereinafter SIEDEL, COMPETITIVE ADVANTAGE].

<sup>17</sup> Downes, *supra* note 10, at 19.

<sup>18</sup> See generally Birger Wernerfelt, *A Resource-based View of the Firm*, 5 STRAT. MGMT. J. 171 (1984). See also Birger Wernerfelt, *The Resource-Based View of the Firm: Ten Years After*, 16 STRAT. MGMT. J. 171, 172 (1995).

resources to take advantage of environmental opportunities.<sup>19</sup> Whereas strategic management research focuses on isolating and addressing a firm's external opportunities and threats,<sup>20</sup> resource-based research develops frameworks that define characteristics that resources must possess in order to confer a strategic advantage.<sup>21</sup>

Numerous theorists have contributed to the current understanding of the resource-based view of competitive advantage. For example, Dierickx and Cool identified asset mass efficiencies, inter-connectedness of assets, asset erosion, and causal ambiguity as sources of competitive advantage.<sup>22</sup> Peteraf examined the impact of superior resources, *ex post* limits to competition, imperfect resource mobility, and *ex ante* limits to competition on competitive advantage.<sup>23</sup> More recently Lavie examined the impact of the interconnectedness of firms on competitive advantage.<sup>24</sup>

While some researchers have refined our understanding of the resource-based view of the firm, others have applied this framework to business sub-specialties. One group of scholars applied the resource-based view by hypothesizing variables in service industries that would be sources of sustainable competitive advantage.<sup>25</sup> Another scholar concluded that firm efforts to obtain competitive advantage had a positive impact on the use of product life cycle cost controls.<sup>26</sup> Scholars have also used the resource-based view to examine the impact of the unit cost of manufacturing, fast delivery, flexibility to change volume, inventory turnover, and cycle time on a firm's competitive advantage.<sup>27</sup> Other scholars developed and applied a cost-knowledge management framework that examined the impact of knowledge management practices on competitive advantage.<sup>28</sup> The ability

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<sup>19</sup> Barney, *supra* note 2, at 99-101. "Most research on sources of sustained competitive advantage has focused either on isolating a firm's opportunities and threats, describing its strengths and weaknesses, or analyzing how these are matched to choose strategies." *Id.* at 99 (citations omitted). The view that firms may obtain sustainable competitive advantage by focusing on strategies that leverage their internal resources to take advantage of environmental opportunities is known as the "resource-based view" of the firm. *Id.* at 99-101. "The resource-based view of the firm . . . is one of the most widely accepted theoretical perspectives in the strategic management field." Scott L. Newbert, *Empirical Research on the Resource-Based View of the Firm: An Assessment and Suggestions for Future Research*, 28 STRAT. MGMT. J. 121, 121 (2007).

<sup>20</sup> See, e.g., MICHAEL PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE (1985); MICHAEL PORTER, COMPETITIVE STRATEGY (1980); Robert Grant, *The Resource-Based Theory of Competitive Advantage: Implications for Strategy Formulation*, 33 CAL. MGMT. REV. 114 (1991).

<sup>21</sup> Val Clulow et al., *The Resource-Based View and Sustainable Competitive Advantage: The Case of the Financial Services Firm*, 27 J. EUR. INDUS. TRAINING 220 (2003).

<sup>22</sup> See generally Ingemar Dierickx & Karel Cool, *Asset Stock Accumulation and Sustainability of Competitive Advantage*, 35 MGMT. SCI. 1504 (1989).

<sup>23</sup> Margaret A. Peteraf, *The Cornerstones of Competitive Advantage: A Resource-Based View*, 14 STRAT. MGMT. J. 179, 180 (1993).

<sup>24</sup> Dovev Lavie, *The Competitive Advantage of Interconnected Firms: An Extension of the Resource-Based View*, 31 ACAD. MGMT. REV. 638 (2006).

<sup>25</sup> Bharadwaj et al., *supra* note 3, at 88-93.

<sup>26</sup> Dunk, *supra* note 4, at 411.

<sup>27</sup> Barbara B. Flynn et al., *The Impact of Quality Management Practices on Performance and Competitive Advantage*, 26 DECISION SCI. 659, 682-84 (1995).

<sup>28</sup> Silvi and Cuganesan, *supra* note 6, at 314-19.

of a firm to turn its human resource systems,<sup>29</sup> organizational capital,<sup>30</sup> or interconnectedness with other firms<sup>31</sup> into a competitive advantage has also been explored. The resource-based view is considered “one of the most influential frameworks of the strategic management literature.”<sup>32</sup>

### *B. The Promising Intersection of Law and Strategy*

In spite of its influence, scholarship studying the resource-based view of the firm has given little attention to law as a competitive advantage. The closest well-developed analogue has been the study of firms’ influence over government public policy.<sup>33</sup> This research addresses the influence of government institutions on firm behavior<sup>34</sup> as well as efforts to change government policy.<sup>35</sup>

The law and strategy research that is the focus of this article is distinct from the study of corporate political activity.<sup>36</sup> Corporate political activity focuses on firm attempts to

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<sup>29</sup> Lado and Wilson, *supra* note 5.

<sup>30</sup> Martín-de-Castro et al., *supra* note 7.

<sup>31</sup> Lavie, *supra* note 24.

<sup>32</sup> *Id.* at 640. Some scholars have called the resource-based view an entirely new theory of the firm. Clulow et al., *supra* note 21, at 220; Kathleen Conner, *A Historical Comparison of Resource-Based Theory and Five Schools of Thought Within Industrial Organization Economics: Do We Have a New Theory of the Firm?*, 17 J. MGMT. 121, 121 (1991).

<sup>33</sup> See, e.g., John C. Aplin & Harvey Hegarty, *Political Influence: Strategies Employed by Organizations to Impact Legislation in Business and Economic Matters*, 23 ACAD. MGMT. J. 438 (1980) (discussing the strategies that business lobbyists, consumer groups, unions, and public agencies may employ in an effort to shape federal legislation); Brian Shaffer & Amy J. Hillman, *The Development of Business-Government Strategies by Diversified Firms*, 21 STRAT. MGMT. J. 175 (2000) (discussing intrafirm conflicts that arise in corporations with diversified business units during the development of government relations strategies). There are thorough literature reviews on this topic. See, e.g., Amy J. Hillman, Gerald D. Keim & Douglas Schuler, *Corporate Political Activity: A Review and Research Agenda*, 30 J. MGMT. 837 (2004) (reviewing the literature in the field since 1995); Kathleen A. Getz, *Research in Corporate Political Action*, 36 BUS. & SOC. 32 (1995) (reviewing the literature addressing corporate political action strategies); Brian Shaffer, *Firm-Level Responses to Government Regulation: Theoretical and Research Approaches*, 21 J. MGMT. 495 (1995) (tracing the development of various theoretical perspectives on business-government relation strategies).

<sup>34</sup> See generally David Baron, *Integrated Strategy: Market and Nonmarket Components*, 37 CAL. MGMT. REV. 47 (1995).

<sup>35</sup> See generally JOHN F. MAHON & RICHARD A. MCGOWAN, *INDUSTRY AS A PLAYER IN THE POLITICAL AND SOCIAL ARENA: DEFINING THE COMPETITIVE ENVIRONMENT* (1996).

<sup>36</sup> Shaping government policy, though important, is not a technique that can be successfully practiced by every firm. One author writes:

The common thread amongst the corporate political activity research is that it treats the firm as an influencer on various political activities. The limitation of such research, however, is that not all firms can influence their legal environment. Many firms, particularly small companies and start-ups, lack the political resources or the experience to participate in political activities. . . . A firm’s political issues and agendas may have life cycles that are too short to justify the costs of lobbying. . . . Even if lobbying is successful, it often benefits an entire industry include a firm’s competitors, thereby negative the advantage obtained by political activities of a single enterprise. [Law and strategy research by contrast] . . . speaks to virtually any firm participating in a competitive market and not simply the most wealthy or influential competitors.

shape government policy. By contrast, law and strategy research examines the ability of managers to extract competitive advantage in a legal environment that is already established. It is this latter stream of research that has been both underdeveloped and holds significant promise.

One example is work by Tom Hinthorne, who noted that historically contingent structures of thought and situational circumstances both enable and constrain the legal actions that serve business ends.<sup>37</sup> Hinthorne applied this concept to the airlines industry to help explain how business practices by managers who understand the law and the associated structures of power will have an enhanced ability to protect and enhance shareholder wealth.<sup>38</sup> Hinthorne concluded that “lawyers and corporate leaders who understand the law . . . have a unique capacity to protect and enhance share-owners wealth.”<sup>39</sup>

Outside the business strategy literature, the discussion of law as a competitive advantage has received greater, but still modest, attention. Initial efforts attempted to view law as a factor in a firm’s competitive environment, placing it on par in strategic value with other disciplines. George Siedel presented a circular framework in which government regulation, litigation and compliance participate equally with other environmental forces such as technology and entrepreneurship to influence firm strategy and operations.<sup>40</sup> James Holloway developed a legal-managerial analysis framework to aid in management decision-making of legal decisions.<sup>41</sup> This framework advocates a common thinking and understanding of legal and management problems and encourages firms to implement decisions in a coordinated fashion.<sup>42</sup> Constance Bagley presented through a case study an examination of the various legal dimensions involved in managerial decision making.<sup>43</sup> Bagley recommends that a firm’s legal strategy and business strategy should be consistent with one another.<sup>44</sup>

These authors have also developed more holistic approaches to viewing law as a strategic tool. Siedel remarked that traditional firms use a fight or flight approach when dealing with legal problems.<sup>45</sup> He suggested that managers “climb to the balcony” to reframe legal issues as business concerns.<sup>46</sup> Applying this concept to a variety of legal topics, he noted that regulation often presents an opportunity for competitive advantage and should

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Robert C. Bird, *Pathways of Legal Strategy*, 14 STAN. J.L. BUS. & FIN. at \*6 (forthcoming 2009).

<sup>37</sup> Tom Hinthorne, *Predatory Capitalism, Pragmatism, and Legal Positivism in the Airlines Industry*, 17 STRAT. MGMT. J. 251 (1996).

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 254.

<sup>40</sup> See Siedel, *Six Forces*, *supra* note 11.

<sup>41</sup> See James E. Holloway, *The Practical Entry and Utility of a Legal-Managerial Framework without the Economic Analysis of Law*, 24 CAMPBELL L. REV. 131 (2002).

<sup>42</sup> *Id.*

<sup>43</sup> See generally CONSTANCE E. BAGLEY & DAVID LANE, X-IT AND KIDDE (A), Case No. 9-803-041 (Harvard Business School ed., May 20, 2003).

<sup>44</sup> *Id.*

<sup>45</sup> SIEDEL, COMPETITIVE ADVANTAGE, *supra* note 16, at 6-7.

<sup>46</sup> *Id.* at 24-25.

be viewed as more than just a cost of doing business.<sup>47</sup> Similarly, Bagley thoughtfully encouraged managers to treat their lawyers as strategic partners in decision-making.<sup>48</sup> Bagley focused on using law as a mechanism for capturing value and reducing risk.<sup>49</sup>

A forthcoming article by the author classifies the legal strategic behavior of firms into five pathways.<sup>50</sup> ‘Avoidance’ firms are defined as those that view regulations as costly and senseless obstacles to be evaded whenever possible.<sup>51</sup> While ‘compliance’ firms seek only to follow the law as written, ‘prevention’ firms implement business approaches to anticipate future legal problems.<sup>52</sup> ‘Advantage’ firms equate the strategic relevance the legal environment with other business disciplines.<sup>53</sup> Finally, the rare ‘transformation’ firm succeeds in using the legal environment to redefine a core mission or aspect of the organization.<sup>54</sup>

Most recently published is Bagley’s article on the value of legal astuteness.<sup>55</sup> This work proposes that legal astuteness, defined as the ability of a top management team to communicate with legal counsel and collaboratively solve problems, is a valuable managerial capability that enhances firms.<sup>56</sup> Legal astuteness is established through a set of value-laden attitudes that accept responsibility for managing legal aspects of business and skillful anticipation of future regulations and how they might be interpreted.<sup>57</sup> It is also established through a proactive approach to regulation, an exercise of thoughtful judgment toward legal opportunities, and possession of legal literacy.<sup>58</sup> Legally astute managers can apply their skills to capture value by using formal contacts to strengthen relationships and reduce transaction costs, protect and enhance the value of firm resources, creating options through contracts and other options, and convert regulatory restraints into opportunities.<sup>59</sup> The article concludes that top management teams having legal astuteness can capture competitive advantages for their firms.<sup>60</sup> A summary of how the legal environment facilitates business goals is illustrated in Exhibit 1.

Scholars are becoming increasingly aware that legal issues are too important to be left to lawyers and that business strategy could significantly benefit from an understanding of

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<sup>47</sup> *Id.* at 25.

<sup>48</sup> CONSTANCE E. BAGLEY, WINNING LEGALLY: USING THE LAW TO CREATE VALUE, MARSHAL RESOURCES, AND MANAGE RISK, Case No. 9-806-138, at 1-2 (Harvard Business School ed., Aug. 4, 2006) (on file with author).

<sup>49</sup> *Id.* at 1-2, 9-12.

<sup>50</sup> Bird, *supra* note 36.

<sup>51</sup> *Id.* at \*12-17.

<sup>52</sup> *Id.* at \*17-27.

<sup>53</sup> *Id.* at \*27-32.

<sup>54</sup> *Id.* at \*32-39.

<sup>55</sup> Constance E. Bagley, *Winning Legally: The Value of Legal Astuteness*, 33 ACAD. MGMT. REV. 378 (2008).

<sup>56</sup> *Id.* at 378.

<sup>57</sup> *Id.* at 379.

<sup>58</sup> *Id.* at 380-82.

<sup>59</sup> *Id.* at 383.

<sup>60</sup> *Id.* at 387.

the legal environment in which all businesses operate. In spite of these welcome advances, the research on law and strategy needs significant development. This next section applies a widely utilized strategy framework to the legal environment and explores whether law may be a source of sustainable competitive advantage.

### *C. Can Legal Resources Support A Sustainable Competitive Advantage?*

Put simply, competitive advantage is defined as a value-creating strategy using firm resources that improves a firm's efficiency or effectiveness in ways not in use by current or potential competitors.<sup>61</sup> Not all firm resources yield advantages. A large bureaucracy, a conservative culture, or an outdated distribution network may confer no advantage or even deter a firm from achieving competitive advantages.<sup>62</sup> Furthermore, not all advantages make firms more competitive. A firm with a favorable building lease, low employee health care costs, or an established history may not necessarily be able to translate these features into a competitive advantage.<sup>63</sup>

Even if a firm establishes a competitive advantage, not all competitive advantages are sustainable ones. Rivals will not hesitate to emulate a competitive advantage thereby nullifying its effectiveness. For example, a company-wide purchase of readily-available information technology may confer an ephemeral benefit as attentive rivals negate that benefit by incorporating the same technology. A firm's competitive advantage is therefore sustainable when it is both not being implemented by rivals and other firms are unable to duplicate the strategy over the long-term.<sup>64</sup> Customers benefit from the practice directly through obtaining superior products or services or indirectly through buying equivalent products or services to rivals at lower prices.<sup>65</sup> As a result, only certain resources can establish the basis for a sustained competitive advantage that can outpace rivals.

Can law be one of those resources? According to some, intangible resources like the legal environment are more likely than tangible resources to produce a competitive advantage and to meet Barney's four conditions.<sup>66</sup> According to Barney, and illustrated as part of

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<sup>61</sup> Barney, *supra* note 2, at 102 (defining "competitive advantage" as the successful implementation of a value-creating strategy "not simultaneously being implemented by any current or potential competitors").

<sup>62</sup> *See id.* at 102 (noting that not all firm resources confer strategic advantages and that some might even "prevent a firm from conceiving of and implementing valuable strategies").

<sup>63</sup> *Id.*

<sup>64</sup> *See id.* at 102.

<sup>65</sup> *See* Busbin, Johnson & DeConinck, *supra* note 1, at 104 ("The [competitive] advantage (or superiority) is sustained (or prolonged) as long as the unique strategy provides value to customers, and as long as competitors cannot find a way to duplicate it.").

<sup>66</sup> *E.g.*, Sylvia J. Flatt & Stanley J. Kowalczyk, *Creating Competitive Advantage through Intangible Assets: The Direct and Indirect Effects of Corporate Culture and Reputation*, 16 *ADVANCES IN COMPETITIVENESS RES.* 13, 15 (2008) (stating that intangible resources are more likely than tangible resources to satisfy Barney's four criteria); Michael A. Hitt et al., *Direct and Moderating Effects of Human Capital on Strategy and Performance in Professional Service Firms: A Resource-Based Perspective*, 44 *ACAD. MGMT. REV.* 13 (2001) (stating that intangible resources are more likely than tangible resources to generate a competitive advantage). *See also* T. Diefenbach, *Intangible Resources: A Categorical System of Knowledge and Other*

Exhibit 2, a firm resource must possess four attributes before it can create a sustained competitive advantage. First, a firm resource must possess **value**.<sup>67</sup> Firm resources are valuable when they enable a firm to implement a strategy that will improve its efficiency or effectiveness.<sup>68</sup> Valuable resources negate threats or enable opportunities depending upon the firm's position in its industry. Valuable resources may also be source of differentiation that firms can exploit.<sup>69</sup>

Laws undoubtedly have some value to firms, if only because they have a significant impact on a firm's internal capabilities. Directors, top managers, and shareholders all benefit from law's clear allocation of power and responsibility. Boards of directors are shielded from constant scrutiny and the threat of litigation by the business judgment rule, which forces courts to defer to the judgment of board members in all but the most grievous of circumstances.<sup>70</sup> Patent laws grant a limited monopoly to inventors that allow them to reap the financial rewards of their innovation. Trademarks shield valuable brands from confusion and tarnishment. Laws prevent executives from publishing misleading information that might manipulate stock prices and shareholders may rely on public information disbursed by firms with confidence.<sup>71</sup> Firms cannot sustain unsafe workplace practices in misguided efforts to improve productivity.<sup>72</sup>

Laws also influence a firm's external environment. Liability statutes regulate the manufacture of products and environmental compliance procedures.<sup>73</sup> Laws lubricate the acquisition of external capital by granting investors limited liability, allowing entrepreneurs to start fresh after a business failure through bankruptcy laws, and establishing the transparency of capital markets through insider trading and disclosure laws.<sup>74</sup> Finally, laws enable free and open labor markets through the prohibition of unwanted discrimination and enabling an employment at will default rule.<sup>75</sup> The legal environment of business enhances firm value.

Second, Barney notes that a resource must be **rare** in order for it to support a sustainable competitive advantage.<sup>76</sup> Barney explains that, at a minimum, the number of firms

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*Intangible Assets*, 7 J. INTELL. CAP. 406, 411-14 (2006) (identifying and discussing law as an intangible asset).

<sup>67</sup> Barney, *supra* note 2, at 106.

<sup>68</sup> *Id.*

<sup>69</sup> Flatt & Kowalczyk, *supra* note 66, at 14.

<sup>70</sup> See Fred W. Triem, *Comment: Judicial Schizophrenia in Corporate Law: Confusing the Standard of Care with the Business Judgment Rule*, 24 ALASKA L. REV. 23, 27 (2007) ("The [business judgment rule] insulates corporate directors from those decisions that are within their authority and are not tainted by fraud or self-dealing.").

<sup>71</sup> In part responsible for the public disclosure requirements placed upon corporations are the Securities Exchange Act of 1933, 15 U.S.C.A. §§ 77a-77aa (2008), the Securities Exchange Act of 1934, 15 U.S.C.A. §§ 78a-78jj (2008), and the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2000) (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C. (2008)).

<sup>72</sup> See, for example, the Occupational Safety and Health Act of 1970. 29 U.S.C. §§ 651-678 (2008).

<sup>73</sup> CONSTANCE E. BAGLEY, *WINNING LEGALLY: HOW TO USE THE LAW TO CREATE VALUE, MARSHAL RESOURCES, AND MANAGE RISK* 32-33 (2005).

<sup>74</sup> *Id.* at 30-31.

<sup>75</sup> *Id.* at 35-37.

<sup>76</sup> Barney, *supra* note 2, at 106.

possessing the valuable resource must be less than the number of firms needed to generate perfect competition in an industry.<sup>77</sup> If all firms possess the same resource, then exploitation of that resource by one firm can be readily copied by rivals, thereby negating the possibility of sustained competitive advantage.<sup>78</sup>

Laws themselves are not rare. Laws are present in virtually every jurisdiction around the world and applicable to virtually every industry that a business can pursue. However, every jurisdiction, location, or practice has its own legal environment to contend with. Each company has its own unique ‘legal mix’ of regulatory issues that it must face. The application of law is also path-dependent, whereby similar firms face distinct legal issues because of previous decisions made on how to pursue goals.<sup>79</sup> For example, while most firms are subject to labor laws, only those that agree to employ unionized workers regularly confront the labor law of strikes, grievances, and labor relations. While a mining enterprise might not prioritize patent protection, patent laws are of critical importance to a pharmaceutical firm. While a firm in Massachusetts may require employees to sign a non-compete agreement to protect that knowledge, a firm in California must find other ways to do so, as such agreements are unenforceable there.<sup>80</sup> A legal mix can vary widely from one company to the other.

The application of law is also path-dependent, meaning that similar firms face distinct legal issues because of previous decisions made on how to pursue goals.<sup>81</sup> For example, a U.S. firm selling product in the European Union faces a host of legal issues that a purely domestic enterprise does not. While two computer companies may manufacture the same technology, one firm may choose to sell to the United States government, requiring a familiarity with complex bidding rules that the other firm selling to private consumers can ignore. A company faces a different set of legal questions depending upon whether it chooses to pursue a foreign direct investment or licensing strategy with its global business.<sup>82</sup> While laws are usually not unique, the confluence of issues a firm faces may be unique to that organization. As a result, individualized decision-making by firms can result in rare or even unique legal conditions based upon geography, industry, consumer markets, or business plans that may be difficult for competitors to duplicate.

Third, a resource must be **imperfectly imitable** by competitors.<sup>83</sup> Barney articulates three sources of imperfectly imitable resources: (a) unique historical conditions (b) a

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<sup>77</sup> *Id.* at 107.

<sup>78</sup> *Id.* at 106.

<sup>79</sup> See generally Julie C. Suk, *Procedural Path Dependence: Discrimination and the Civil-Criminal Divide*, 85 WASH. U. L. REV. 1315, 1323-1325 (2008) (explaining path dependence).

<sup>80</sup> Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 575 (1999).

<sup>81</sup> See generally Julie C. Suk, *Procedural Path Dependence: Discrimination and the Civil-Criminal Divide*, 85 WASH. U. L. REV. 1315, 1323-1325 (2008) (explaining path dependence).

<sup>82</sup> See Farok J. Contractor, *Choosing Between Direct Investment and Licensing: Theoretical Considerations and Empirical Tests*, 15 J. INT'L BUS. STUD. 167 (1984).

<sup>83</sup> Barney, *supra* note 2, at 106.

causally ambiguous link between a firm's resources and its advantage, or (c) social complexities.<sup>84</sup> Each source can be found in the legal environment.

Firms may receive advantages from unique historical conditions through selection or retention of a favorable jurisdiction. Established firms benefit from “grandfather clauses”—legislative clauses exempting pre-existing classes of firms from the requirements of new regulations.<sup>85</sup> For example, the Clean Air Act permits older, existing manufacturing facilities to operate according to less stringent and less costly regulations than their more modern counterparts.<sup>86</sup> Another federal law, enacted in 1988 to rectify a statutory loophole that allowed firms to improperly exploit a patented business process, exempted firms who were already engaging in the practice prior to the act.<sup>87</sup> A Virginia banking law allows certain banks to operate insurance divisions if they were during so by the early 1970s, even though today such operations are illegal in Virginia today.<sup>88</sup> For newer firms in these jurisdictions, such legal advantages are impossible to imitate.

Causal ambiguity occurs when the link between a firm's resources and its competitive advantage is poorly understood by its rivals.<sup>89</sup> Legal resources lend themselves to causal ambiguity. Legal advice, offered by lawyers who commonly act as liaisons between legal rules and business practice, is a protected source of information. A robust attorney-client privilege bars disclosure of communications between executive and counsel in the great majority of circumstances.<sup>90</sup> The purveyance of legal services also does not have an easily-perceived external expression. If a firm constructs a new factory in a new market, the plant's presence betrays the firm's strategy to any watchful rival. Legal advice, by contrast, exists largely largely the files of company counsel. It is neither tangible nor fungible, and rarely expressed to the public in company plans. Thus, at least from the perspective of rivals, the connection between legal resources and a firm's competitive advantage can be causally ambiguous.

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<sup>84</sup> *Id.* at 107 (citing Dierickx & Cool, *supra* note 22).

<sup>85</sup> See Heidi Gorovitz Robertson, *If Your Grandfather Could Pollute, So Can You: Environmental Clauses and Their Role in Environmental Equity*, 45 CATH. U.L. REV. 131, 132 (1995) (“In congressional jargon, a grandfather clause lets somebody who's already doing something keep doing it after Congress decrees it shouldn't be done anymore.”) (quoting Jerry Knight, *Legislators to Load Bank Bill With “Special” Amendments*, WASH. POST, July 4, 1991, at B9).

<sup>86</sup> *Id.* at 152.

<sup>87</sup> Robert R. Deveza, *A Grandfather Clause, Due Process, and the GATT: Whatever Happened to the Grandfather Clause of the Process Patent Act of 1988?*, 18 RUTGERS COMP. & TECH. L.J. 65, 65-66 (1992).

<sup>88</sup> Robertson, *supra* note 85, at 133 n.8.

<sup>89</sup> James J. Hoffman, *Social Capital, Knowledge Management, and Sustained Superior Performance*, 9 J. KNOWLEDGE MGMT. 93, 93 (2005); Adelaide Wilcox King, *Disentangling Interfirm and Intrafirm Causal Ambiguity: A Conceptual Model of Causal Ambiguity and Sustainable Competitive Advantage*, 32 ACAD. MGMT. REV. 156, 156-57 (2007).

<sup>90</sup> See, e.g., John W. Gergacz, *A Proposal for Protecting Executive Communications with Corporate Counsel After the Corporate Client has Waived its Attorney-Client Privilege*, 13 FORDHAM J. CORP. & FIN. L. 35 (2008); Scott R. Fluke, *The Attorney-Client Privilege in the Corporate Setting: Counsel's Dual Role as Attorney and Executive*, 62 UMKC L. REV. 549 (1994).

Social complexity arises when the source of a competitive advantage is known but the method of replicating the advantage is difficult to identify due to social phenomena.<sup>91</sup> Conditions such as a employee loyalty or a culture of creativity can be difficult to analyze and replicate.<sup>92</sup> Social complexity can exist in the legal environment. For example, firms place a premium on having strong positive working relationships with regulatory authorities.<sup>93</sup> These relationships can have difficult to imitate characteristics such as trust, shared commitment to goals, and mutual respect. If the firm breaks a rule, a regulator that trusts firm management to not do it again might reduce the penalty due to a prior positive relationship. Such relationships can also encourage flexibility in compliance. For example, if an environmental regulator gives slack to a facility by relaxing its permit standards, facility managers may feel an obligation to respond with future improvements in environmental performance in order to maintain a good relationship with the regulator.<sup>94</sup>

Relationships with regulators can also build trust, which in turn can open doors for firms seeking legal approval. For example, PNC Bank transformed a legal headache into an opportunity by aggressively responding to bank regulator concerns over deficiencies in corporate governance.<sup>95</sup> Instead of dragging its feet, PNC Bank built a ‘best-in-class’ governance and risk management model.<sup>96</sup> Based on the strong relationship it had forged with regulators, it received approval to complete a desired bank acquisition.<sup>97</sup>

Of course not every manager can build a personal relationship with government regulators. Managers do have opportunities, however, to build contractual relationships with suppliers or buyers that are potentially laden with social complexity. The nature of social complexity in legal agreements has been widely discussed by Ian Macneil, credited

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<sup>91</sup> Barney, *supra* note 2, at 110.

<sup>92</sup> *Id.*

<sup>93</sup> *E.g.*, Paul H. Irving & T. Hale Boggs, *Financial Institution Directors: Mitigating Risks of Liability in Shareholder Actions*, 109 *BANKING L.J.* 336, 353 (1992) (“Directors should attempt to maintain constructive relations with their institution’s regulators. A good working relationship may be of great benefit in situations where an examiner is making his or her evaluation of the institution’s condition.”); Donna L. Kolar, *Practical Advice for Permitting a Waste Disposal Facility*, 4 *NAT. RES. & ENV’T.* 11, 42 (discussing operation of a waste disposal facility and concluding that “[t]he importance of good working regulatory relationships cannot be stressed enough. The agencies are not industry’s enemies. Permittees and the regulatory agencies are on the same side—ensuring safe disposal of waste.”). Such a relationship is not always perceived as a good thing from the regulator’s perspective. *See* Todd Lochner & Bruce E. Cain, *Equity and Efficacy in the Enforcement of Campaign Finance Laws*, 77 *TEX. L. REV.* 1891, 1900 n.35 (1999) (commenting that “the viewpoint that the presence of a good working relationship between regulators and regulatees suggests that the agency is not doing its job is a distinctly American way of viewing government-business relations.”)

<sup>94</sup> *See* Robert L. Glicksman & Dietrich H. Earnhart, *Effectiveness of Government Interventions at Inducing Better Environmental Performance: Does Effectiveness Depend on Facility or Firm Features?*, 35 *B.C. ENVTL. AFF. L. REV.* 479, 488-89 (2008) (describing this exchange as a reciprocity norm).

<sup>95</sup> Edward D. Herlihy et al., *The Evolving Landscape of Financial Institutions M&A: An Analysis of Current Trends and Developments, An Annual Review of Lending Developments*, 1575 *PLI/CORP* 109, 148-49 (2006).

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

for popularizing relational contract theory.<sup>98</sup> Relational contract scholars theorize that firms who form arrangements with one another develop a relationship that generates planning, trust, and solidarity norms that far exceed the terms of the original agreement.<sup>99</sup> Such norms promote cooperative behavior between the contracting parties and inhibit opportunism.<sup>100</sup> Firms in relational contracts pre-arrange dispute resolution mechanisms, make partner-specific capital investments, and incorporate flexibility for unexpected mishaps.<sup>101</sup> Relationally-based business to business partners may maintain friendships, share experiences, or communicate about issues in the industry.<sup>102</sup> In short, parties in relationally-based legal arrangements give and take more from each other than is required by the written terms of the contract between them.<sup>103</sup> These relational contracts are inherently complex and multifaceted.

Engaging in the socially-complex practice of relational contracting is no mere altruism. Socially-complex relationships between employers and employees result in lower turnover, higher job satisfaction for employees, and enhanced employee loyalty compared to firms who do not establish or break relational norms.<sup>104</sup> Relational contracts between businesses may result in investments in relation-specific assets, an exchange of knowledge that mutually benefits all involved parties, the combining of complimentary and scarce resources, and lower transaction costs.<sup>105</sup> Thus, contracts and regulatory obligations enmeshed in a broader social matrix can create competitive advantages that impersonally applied regulations and contracts do not allow.

Finally, Barney explains that a resource granting a sustainable competitive advantage must **lack of equivalent substitutes**.<sup>106</sup> According to Barney, if a rival can copy a firm's valuable and rare competitive resource through different but strategically equivalent means, that firm's competitive advantage will not be sustainable over the long term.<sup>107</sup>

Finding substitutes for legal regulation is not easy. If a firm wants to conduct business in the United States, for example, that firm must subject itself to the regulations of federal

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<sup>98</sup> See generally IAN R. MACNEIL, *THE RELATIONAL THEORY OF CONTRACT: SELECTED WORKS OF IAN MACNEIL* (David Campbell ed., 2001).

<sup>99</sup> Robert C. Bird, *Employment as a Relational Contract*, 8 U. PA. J. LAB. & EMP. L. 149, 151 (2005).

<sup>100</sup> *Id.* at 153 (citing Richard E. Speidel, *The Characteristics and Challenges of Relational Contracts*, 94 NW. U.L. REV. 823, 829-30 (2000)).

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* (citing Robert W. Gordon, *Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 WIS. L. REV. 565, 570). See also Jeffrey H. Dyer & Harbir Singh, *The Relational View: Cooperative Strategy and Sources of Interorganizational Competitive Advantage*, 23 ACAD. MGMT. REV. 660 (1998) (discussing the competitive advantages that may be afforded to firms through different forms of interfirm partnerships).

<sup>104</sup> *Id.* at 154 (citing PEGGY SIMONSEN, *PROMOTING A DEVELOPMENT CULTURE IN YOUR ORGANIZATION: USING CAREER DEVELOPMENT AS A CHANGE AGENT* (1997); Philip H. Mirvis & Douglas T. Hall, *Psychological Success and the Boundaryless Career*, 15 J. ORG. BEHAV. 365 (1994)).

<sup>105</sup> Dyer & Singh, *supra* note 103, at 660.

<sup>106</sup> Barney, *supra* note 2, at 106.

<sup>107</sup> *Id.* at 111.

and state law. Firms cannot select alternate legal systems because the ones that exist in their target market do not suit their liking.

This is not to say that firms have utterly no alternative when submitting to a legal regime, but the alternative can be very costly, difficult to obtain, or available only to a select few. Firms can certainly draft contracts that override default rules with terms that suit their needs. Firms run the risk of having their terms rejected by others or deemed unenforceable by a court. Wealthy firms can attempt to create legal substitutes by lobbying legislators to change federal or state statutes in whatever field they occupy.<sup>108</sup> Firms may also attempt to shape the common law.<sup>109</sup> For example, Wal-Mart carefully selects the lawsuits that it chooses to take to trial (rather than settle) so that it can establish favorable judicial precedents that will make subsequent cases against it more difficult to win.<sup>110</sup> Few firms, however, lack the size or near-continuous contact with the legal system to make this a viable approach.

Firms can also shift jurisdictions to obtain a favorable legal environment. Governments use inter-jurisdictional competition in order to attract investment. Favorable employment laws may attract employers concerned about workplace-related costs and lawsuits.<sup>111</sup> Through favorable corporate laws Delaware skillfully positioned itself as the market leader for business entity formation.<sup>112</sup> Offshore banking institutions have attracted large quantities of assets from U.S. companies seeking favorable financial laws.<sup>113</sup>

Yet, the substitutability of laws remains limited. However, moving an entire operation of employees just to capture a legal substitute can be a costly burden indeed. Even if regulatory arbitrage is low cost, interjurisdictional advantages may converge away over time.<sup>114</sup> For example, intellectual property laws among developed nations are now far more similar to one another than they were twenty years ago, and that trend is likely to continue to minimize the advantage of one nation's laws over another.<sup>115</sup> In spite of

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<sup>108</sup> A cable television conglomerate, for example, might elect to devote some portion of its income to FCC lobbying efforts. See, e.g. ERWIN G. KRASNOW ET AL., *FCC LOBBYING: A HANDBOOK OF INSIDER TIPS AND PRACTICAL ADVICE* (2001).

<sup>109</sup> Lea VanderVelde, *Wal-Mart as a Phenomenon in the Legal World: Matters of Scale, Scale Matters*, in *WAL-MART WORLD: THE WORLD'S BIGGEST CORPORATION IN THE GLOBAL ECONOMY* 115, 115 (Stanley D. Brunn ed., 2006) ("It is theoretically well established that large firms can and do pursue legal strategies that shape the common law not only for themselves but for all those that come after.").

<sup>110</sup> See *id.* at 117-20 (noting that Wal-Mart's tremendous size gives it the ability to influence the shape and development of the common law by selecting which disputes to defend in court and which to settle).

<sup>111</sup> E.g., Timothy P. Glynn, *Interjurisdictional Competition in Enforcing Non-Competition Agreements: Regulatory Risk Management and Race to the Bottom*, 65 WASH. & LEE L. REV. \_\_\_ (forthcoming 2009).

<sup>112</sup> Lucian Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391-92 (2003) (Delaware receives sixty percent of all publicly traded incorporations)

<sup>113</sup> Dale D. Murphy, *Interjurisdictional Competition and Regulatory Advantage*, 8 J. INT'L ECON. L. 891, 897-907 (2005).

<sup>114</sup> *Id.* at 916-18. See also SIEDEL, *supra* note 16, at 17-18.

<sup>115</sup> Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 109-10 (2005) (attributing the globalization of intellectual property law to, among other things, the proliferation of regional trading agreements, such as the North American Free Trade Agreement and the Agreement on Trade-Related Aspects of Intellectual Property Rights).

Delaware's market leadership, the advantages of Delaware corporate law structure, for example, have been eroded by other business-hungry states following Delaware's lead.<sup>116</sup> Some legal resources can be substitutable. Many laws, however, lack ready substitutes because significant transaction costs exist and differences between state and national jurisdictions may disappear over time. Thus, the legal environment of business can possess a lack of sufficient substitutes necessary to establish a sustainable competitive advantage.

Establishing that the legal environment can present all four pre-conditions for achieving a sustainable competitive advantage shows that legally-knowledgeable personnel have at least some role to play in furthering a firm's strategic goals. Yet, just because a sustainable competitive advantage is possible does not necessarily mean that managers understand how to operationalize that advantage. The next section of this article addresses this issue, exploring what conditions can most effectively create an environment where legally strategic behavior will thrive.

## II. WHAT FACTORS INFLUENCE LEGAL STRATEGY FORMATION?

If the legal environment can create sustainably competitive advantages, then what characteristics of firms and managers best promote legally strategic behavior? Just as scholars study the conditions of firms that promote innovation<sup>117</sup> and creativity<sup>118</sup>, so the characteristics that might drive legally strategic behavior are valuable to understand. Encouraging these conditions to thrive can help firms improve their performance. Given the probability that few managers currently perceive law as a strategic tool, development of a strategy is likely offer firms an advantage that rivals will be slow to replicate. This section explores potential drivers for strategic behavior by reviewing two categories of variables. First, this section examines the attitudinal perceptions of managers that might promote or deter strategic thinking. Second, this section examines the enabling attributes of companies. This part concludes that both attitudinal and attributive variables can encourage legal strategy.

### *A. Attitudinal Variables: Perceptions of Law, Lawyers, and the Judicial Process*

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<sup>116</sup> Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1443 (1992).

<sup>117</sup> E.g., Leslie H. Vincent, Sundar G. Bharadwaj & Goutam N. Challagalla, *Antecedents, Consequences, and the Mediating Role of Organizational Innovation: Empirical Generalizations*, available at [https://mercury.smu.edu.sg/rsrchpubupload/5676/innmeta\\_ms070805pdf.pdf](https://mercury.smu.edu.sg/rsrchpubupload/5676/innmeta_ms070805pdf.pdf). See also Eric H. Kessler & Alok K. Chakrabarti, *Innovation Speed: A Conceptual Model of Context, Antecedents, and Outcomes*, 21 ACAD. MGMT. REV. 1143 (1996).

<sup>118</sup> E.g., Cameron M. Ford, Mark P. Sharfman & James W. Dean, *Factors Associated with Creative Strategic Decisions*, 17 CREATIVITY & INNOVATION MGMT. 171 (2008) (finding that creativity may improve effectiveness of strategic choices); Mohamed M. Mostafa & Ahmed El-Masry, *Perceived Barriers to Organizational Creativity; A Cross-Cultural Study of British and Egyptian Future Marketing Managers*, 15 CROSS CULT. MGMT. 81 (2008) (studying how future managers perceive creativity barriers in order to stimulate creative behavior); J. Benjamin Forbes & Donald R. Domm, *Creativity and Productivity: Resolving the Conflict*, 69 S.A.M. ADV. MGMT. J. 4 (2004).

The first broad category that can be explored is the attitudes of managers that populate firms. The group of attitudes that managers possess are known generally as attitudinal variables. Attitudinal variables are viewpoints that are embodied by individuals that may impact a person's decisions, interests, values, or behaviors. Key decision-makers in an organization can influence a firm's strategy through their attitudinal-influenced decisions.<sup>119</sup>

The attitudes of managers toward firm activities have been the subject of repeated study. Little research exists on manager attitudes towards business laws. The closest available analogue has been the study of manager attitudes toward ethics. For example, one study found that the degree of religious belief held by small business managers was positively associated with a commitment to social responsibility.<sup>120</sup> Another explored the nature and extent of managers' perception of the electronic monitoring of employee behavior as an ethical act.<sup>121</sup> Manager attitudes have also been studied for cross-cultural comparisons, finding that national culture has a strong impact on managers' ethical beliefs and personal integrity.<sup>122</sup>

Beyond ethics, the study of manager attitudes has been as wide ranging as the factors that impact business. One study examined whether a manager's attitude towards supply management impacted firm performance.<sup>123</sup> Others have explored attitudes toward change,<sup>124</sup> markets and marketing,<sup>125</sup> unions,<sup>126</sup> and destabilizing organizational pressures.<sup>127</sup> Still other research has explored attitudes toward managers. One study examined the varying attitudes of college students toward women managers.<sup>128</sup> Another revealed that the perceived behavioral integrity of managers was positively associated

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<sup>119</sup> See generally Deborah G. Ancona & David A. Nadler, *Top Hats and Executive Tails: Designing the Senior Team*, 31 SLOAN MGMT. REV. 19 (1989); Paula Caligiuri et al., *Top Managers' National Diversity and Boundary Spanning: Attitudinal Indicators of a Firm's Internationalization*, 23 J. MGMT. DEV. 848 (2004); Andrew M. Pettigrew, *On Studying Managerial Elites*, 13 STRAT. MGMT. J. 63 (1992).

<sup>120</sup> Robin T. Peterson & Minjoon Jun, *Small Business Manager Attitudes Relating to the Significance of Social Responsibility Issues: A Longitudinal Study*, 11 J. APP. MGMT. & ENTREPRENEURSHIP 32 (2006). See also Lyman E. Ostlund, *Attitudes of Managers toward Corporate Social Responsibility*, 19 CAL. MGMT. REV. 35 (1977).

<sup>121</sup> Bobby C. Vaught, Raymond E. Taylor & Steven F. Vaught, *The Attitudes of Managers Regarding the Electronic Monitoring of Employee Behavior: Procedural and Ethical Considerations*, 18 AM. BUS. REV. 107 (2000).

<sup>122</sup> P. Maria Joseph Christie et al., *A Cross-Cultural Comparison of Ethical Attitudes of Business Managers: India, Korea and the United States*, 46 J. BUS. ETHICS 263 (2003).

<sup>123</sup> Vijay R Kannan & Keah Choon Tan, *Attitudes of US and European Managers to Supplier Selection and Assessment and Implications for Business Performance*, 10 BENCHMARKING 472 (2003).

<sup>124</sup> Douglas Davis & Thomas Fisher, *Attitudes of Middle Managers to Quality-Based Organisational Change*, 12 MANAGING SERVICE QUALITY 40 (2002).

<sup>125</sup> Marie Pribova & Ronald Savitt, *Attitudes of Czech managers Towards Markets and Marketing*, 12 INT'L MKTNG. REV. 60 (1995).

<sup>126</sup> Ishak Saporta & Bryan Lincoln, *Managers' and Workers' Attitudes Toward Unions in the U.S. and Canada*, 50 RELATIONS INDUSTRIELLES 550 (1995).

<sup>127</sup> Anne H. Reilly, Jeanne M. Brett & Linda K Stroh, *The Impact of Corporate Turbulence on Managers' Attitudes*, 14 STRAT. MGMT. J. 167 (1993).

<sup>128</sup> Nuray Sakalli-Ugurlu & Basak Beydogan, *Turkish College Students' Attitudes toward Women Managers: The Effects of Patriarchy, Sexism, and Gender Differences*, 136 J. PSYCH. 647 (2002).

with employee job satisfaction, organizational commitment, leader satisfaction, and affect toward the organization.<sup>129</sup>

Numerous unexplored attitudinal variables may influence strategic legal behavior. The antecedents and consequences of managers' attitudes toward legal rules overall remains ripe for study. A manager's interaction with his or her legal environment can vary quite widely. At one extreme, managers view legal rules has impediments to goals to be ignored or subverted whenever profitable. One former safety manager at McWane Corporation, an owner of pipe foundries that received national attention because of its alleged poor treatment of employees and safety practices,<sup>130</sup> commented in an televised interview that, "[t]he McWane way is don't tell anybody [government regulators charged with enforcing OSHA safety laws] anything . . . I mean you don't convict yourself. Let them do it, that's what they get paid for."<sup>131</sup> An environmental lawyer familiar with McWane's practices commented, "McWane's attitude is 'unless you catch us, unless you push us, unless you were right up to . . . it, to the limit, we're not gonna do anything we have to do.'"<sup>132</sup>

On the other extreme, managers may view regulation as an opportunity for growth. When the controversial Sarbanes-Oxley Act of 2002 (SOX) was passed, most managers questioned the need for the significant burdens imposed upon them, viewing the Act as something that subjects managers to the same compliance obligations as those who have been negligent or dishonest.<sup>133</sup> A minority of managers viewed the new regulations, which in part placed responsibility on management for maintaining sound internal financial controls, "approached the new law with something like gratitude."<sup>134</sup> This group did not focus on literal compliance but rather found ways to use the new law as a springboard for implementing performance-enhancing internal reforms.<sup>135</sup> When a digital asset management firm combined SOX-based reforms with business strategies, the firm gained a competitive advantage in consolidating data management, streamlining customer orders, and expanding the capabilities of their supply chain.<sup>136</sup>

Intriguing questions underlie these different managerial attitudes toward the legal system. Perhaps the Vice President of Finance and Chief Accounting Officer of RSA Security, John Parsons, and his team already had an embedded attitude of respect towards the law when he was responsible for implementing SOX's requirements. This respect may have come from attitudes expressed by his CEO or fellow executives. A belief may permeate

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<sup>129</sup> Anne L. Davis & Hannah R. Rothstein, *The Effects of the Perceived Behavioral Integrity of Managers on Employee Attitudes: A Meta-analysis*, 67 J. BUS. ETHICS 407 (2006). The study defined behavioral integrity in part as "the fit between what the manager says and what the manager does, and includes the perception of managerial behavior that is supportive of the organization's mission." *Id.* at 408.

<sup>130</sup> Frontline: A Dangerous Business (PBS television broadcast Jan. 9, 2003), transcript available at <http://www.pbs.org/wgbh/pages/frontline/shows/workplace/etc/script.html>.

<sup>131</sup> *Id.* (statement of Clyde Dorn).

<sup>132</sup> *Id.* (statement of Bart Slawson).

<sup>133</sup> Wagner & Dittmar, *supra* note 13, at 1.

<sup>134</sup> *Id.* at 1.

<sup>135</sup> *Id.* at 1-2.

<sup>136</sup> *Id.* at 6.

the organization that fair regulation is necessary to maintain sound business practices. Perhaps the firm's ability to communicate freely across disciplines allowed for the formation of a cross-functional team that could integrate legal rules and business opportunities seamlessly into a strategic plan. By contrast, the McWane environment may possess none of these enabling characteristics or even be filled with pressure from executives to ignore the law. Isolating the drivers of positive managerial attitudes toward law may also isolate drivers for enabling legally strategic behavior.

A firm's belief that law can be shaped through its own efforts may be associated with the ability of a firm to use law strategically. The most obvious efforts by firms to shape their legal environment is through corporate political activity, which many firms do directly through lobbying or indirectly through trade groups that advocate on their behalf.<sup>137</sup> Successful lobbying practices may engender in managers a sense of self-efficacy toward the law.<sup>138</sup> While some managers may view laws as something immutable to control and resign themselves to reactive behavior, others that have implemented or witnessed favorable legal changes may view new regulations more malleably. A firm experienced with presenting the business impacts of legal rules to legislators may realize that it can use regulations in a way that captures a competitive advantage over rivals. While the ability to use laws strategically may be widespread, the belief that a firm has the ability to perceive laws as more than compliance rules may be rare indeed.

Attitudes toward legal process may also influence the propensity towards strategy. A manager may have a negative experience with litigation or arbitration, either as a defendant or as a non-party participant.<sup>139</sup> A manager may also suffer the scrutiny of overzealous enforcement. For example, in securities regulation, United States regulators apparently compete to be one what author calls the "toughest cop on the street" where regulation of markets in the United Kingdom tend to be more collaborative and solution oriented.<sup>140</sup> Different experiences with regulators can shape how laws are perceived and utilized. A manager subjected to a searching audit or uncompromising government scrutiny may view the legal process as biased in favor of government and against business. A manager viewing legal processes as inherently unfair may be more likely to work outside legal structures (illegal behavior) than within them (strategic behavior). If a

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<sup>137</sup> See Hillman, Keim & Schuler, *supra* note 33; Shaffer, *supra* note 33.

<sup>138</sup> Self-efficacy has been defined as "the personal judgment of one's own capability to successfully perform a behavior." Lynne R. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363, 1394 n.149 (2002). See also Clay Calvert, *Excising Media Images to Solve Societal Ills: Communication, Media Effects, Social Science and the Regulation of Tobacco Advertising*, 27 SW. U. L. REV. 401, 452 n.354 (1998) (defining self-efficacy as "people's judgments of their capabilities to organize and execute courses of action required to attain designated types of performances. It is concerned not with the skills one has but with the judgments of what one can do with whatever skills one possesses.").

<sup>139</sup> Russel Myles & Kelly Reese, *Arbitration: Avoiding the Runaway Jury*, 23 AM. J. TRIAL ADVOC. 129, 133 (1999).

<sup>140</sup> Joseph Silvia, *Efficiency and Effectiveness in Securities Regulation: Comparative Analysis of the United States's Competitive Regulatory Structure and the United Kingdom's Single Regulator Model*, 6 DEPAUL BUS. & COM. L.J. 247, 260 (2008) (citing Charles E. Schumer & Michael R. Bloomberg, *To Save New York, Learn From London*, WALL ST. J., Nov. 1, 2006, at A18).

manager has not experienced successful collaboration with regulators it is unlikely that the manager will consider collaboration with regulators as an opportunity.<sup>141</sup>

An intriguing variable is the attitude that managers and executives have toward lawyers. Lawyers have a poor reputation amongst businesspeople. Lawyers are perceived as being overly conservative, quick to throw up barriers, and more interested in legal technicalities than furthering the goals of their client. Manager may dismiss a lawyer's counsel assuming that lawyers create problems so that they can justify their own existence.<sup>142</sup> While some managers genuinely desire an attorney who will provide the most objective counsel possible, other managers may want a more 'client focused' lawyer who will find a way to accomplish the firm's objectives regardless of their wisdom or legality.<sup>143</sup> Added to the difficulty lawyers face is that they are often the bringers of bad news. As Elihu Root reportedly observed, "half of the practice of a decent lawyer consists in telling would-be clients that they are damned fools and should stop."<sup>144</sup> There is thus ample opportunity for managers to view their counsel as obstructionist and out-of-touch.

Surveys reinforce this perception. When a law school surveyed small business owners, it revealed an unexpected degree of skepticism and hostility towards lawyers.<sup>145</sup> "Authoritative," "conservative," "arrogant," and "intimidating" were words used by these owners to describe attorneys.<sup>146</sup> Respondents complained that attorneys refuse to admit mistakes and failed to know answers to client questions.<sup>147</sup> Productivity was measured by how many documents were produced rather than solving a problem quickly and cheaply.<sup>148</sup> One participant reported that a law firm hired for a routine acquisition refused to rely on documents already vetted by other lawyers and mushroomed the transaction into a \$27,000 legal bill.<sup>149</sup>

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<sup>141</sup> See generally Richard W. Painter, *Game Theoretic and Contractarian Paradigms in the Uneasy Relationship between Regulators and Regulatory Lawyers*, 65 *FORDHAM L. REV.* 149 (1996) (examining relationships between regulators, regulated firms, and lawyers from the vantage point of game theory and Coasean contractual theory).

<sup>142</sup> Bird, *supra* note 36, at \*13.

<sup>143</sup> Fred C. Zacharias, *Effects of Reputation on the Legal Profession*, 65 *WASH. & LEE L. REV.* 173, 190-91 (2008).

<sup>144</sup> *Id.* at 190 n.53 (citing 1 Phillip C. Jessup, *ELIHU ROOT* 133 (1938)).

<sup>145</sup> Milo Geyelin, *More Law Schools Are Teaching Students Value of Assuming Clients' Point of View*, *WALL ST. J.*, Sept. 17, 1991, at B1. Data regarding attitudes towards legal structures may be gathered by questions posed through typical five- or seven-point Likert scaling from "strongly agree" to "strongly disagree" that is commonly used to capture attitudinal perceptions. See, e.g., I. Elaine Allen, Christopher A. Seaman, *Likert Scales and Data Analyses*, *QUAL. PROG.*, July 2007, at 64, 64 ("Likert scales are a common ratings format for surveys. Respondents rank quality from high to low or best to worst using five to seven scales."); Rachele Cortis & Vincent Cassar, *Perceptions of and About Women as Managers: Investigating Job Involvement, Self-Esteem and Attitudes*, 20 *WOMEN IN MGMT. REV.* 149, 153 (2005) (applying a four-point Likert scale ranging from "strongly agree" to "strongly disagree" to gauge attitudes about women as managers).

<sup>146</sup> Geyelin, *supra* note 145, at B1.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

Just as plant managers have been surveyed to study the impact of management practices on competitive advantage,<sup>150</sup> so can other researchers survey corporate counsel, top executives, or in-house legal staff to understand how managers and executives perceive law and lawyers. A survey of Fortune 500 CEOs revealed that while 96% of general counsel worked on “regulatory compliance” matters, only 62% served in a “strategic development” capacity.<sup>151</sup> Similarly, while 69% of the surveyed CEOs reported that the most important role of general counsel was to “find solutions to legal problems,” only 31% stated that it was to “develop advantages in the legal and regulatory framework” of the industry.<sup>152</sup> This survey also revealed that only 4% of CEOs surveyed believed that strategic thinking would be a skill set sought in a new general counsel.<sup>153</sup> By contrast, other nationwide interviews of CEOs and general counsel have revealed no predictable attitude toward lawyers from CEOs who had themselves practiced law.<sup>154</sup>

There is evidence, however, that in-house counsel may be positioning themselves as more sensitive to the goals of top management. Nelson and Nielsen interviewed forty-two corporate counsel from twenty-two Fortune 1,000 companies in order to better understand their role as legal advisor.<sup>155</sup> The authors concluded that corporate counsel generally performed one of three roles: a cop role, a counsel role, or an entrepreneur role.<sup>156</sup> Attorneys playing the cop role mostly performed legal gate-keeping functions such as imposing compliance programs, approving contracts, and responding to legal questions.<sup>157</sup> Cop-attorneys emphasized the importance of independent judgment and saying “no” when a proposed action was illegal.<sup>158</sup> Counsel-attorneys, by contrast, also perform gate-keeping roles but expand their relationship with into one that makes suggestions based on business, ethical, and situational concerns.<sup>159</sup>

Entrepreneur-attorneys were the third and most multifaceted category of in-house counsel. The authors insightfully describe entrepreneur-attorneys as those who, “say law is not merely a necessary complement to corporate functions, law can itself be a source of profits, an instrument to be used aggressively in the marketplace, or the mechanism through which major transactions are executed.”<sup>160</sup> The authors concluded that these counsel derive meaning from furthering the business conception of the corporation, a

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<sup>150</sup> See, e.g., Flynn et al., *supra* note 27, at 659, 668.

<sup>151</sup> HEIDRICK & STRUGGLES INT’L, INC. & THE MINORITY CORP. COUNSEL ASS’N, THE FORTUNE 500 CEO SURVEY ON GENERAL COUNSELS 2 (2000). The question asked to respondents was, “[w]hat are the strategic issues that General Counsel work on?” *Id.*

<sup>152</sup> *Id.* at 5.

<sup>153</sup> *Id.* at 3. Interestingly, only four-percent of CEOs responded that “business” would be a skill set sought after in general counsel as well. *Id.*

<sup>154</sup> Larry Smith, *Lawyer-CEOs: No Predictable Attitudes Concerning Legal Function*, 11 OF COUNSEL 28, 28 (1992).

<sup>155</sup> Robert L. Nelson & Laura Beth Nielsen, *Cops, Counsel and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations*, 34 LAW & SOC’Y REV. 457 (2000).

<sup>156</sup> *Id.* at 462.

<sup>157</sup> *Id.* at 463.

<sup>158</sup> *Id.* at 463-64.

<sup>159</sup> *Id.* at 464.

<sup>160</sup> *Id.* at 466.

profit-making and capitalist institution.<sup>161</sup> In-house counsel interviewed of this type expressed enthusiasm for making deals, raising money, and acquiring other companies.<sup>162</sup> They offered advice beyond the legal function not only because they felt comfortable doing so but were expected to do so by fellow executives.<sup>163</sup> Business achievements rather than legal objectives may primarily motivate such counsel.<sup>164</sup>

These results offer intriguing insights into the potential of corporate counsel as a source of strategy. One-third of the attorneys in the sample filled the entrepreneurial role while only seventeen percent approximated the cop role in the organization.<sup>165</sup> With half of surveyed attorneys playing a counsel role, the majority of those interviewed saw themselves as having some role beyond legal compliance and gate-keeping. It is likely that the more in-house attorneys see themselves as counsel and entrepreneurs, the more likely that legally strategic behavior will arise from their practices. These attorneys may have many of the necessary antecedents, including a strong legal background, a proactive approach towards business decisions, the ability to exercise judgment, and an attitude of responsibility.<sup>166</sup>

Finally, legally strategic behavior might be influenced by managers' attitudes toward risk. Scholars have explored managers' attitudes toward risk using a variety of criteria.<sup>167</sup> Management may not implement an otherwise meritorious strategy because of the perceived risk of a field, like law, with which managers might not be familiar.<sup>168</sup> Taking a strategic approach to law is an inherently risky venture. Internally, managers might encounter resistance from colleagues and take disproportionate blame if a novel strategy fails. Externally, a careless legal strategy may run afoul of legal rules not properly considered by the manager.

Amplifying the impact of risk on legal strategy is the apparent propensity of managers to significantly overestimate the risks of new regulation.<sup>169</sup> One study found that the

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<sup>161</sup> *Id.* at 468.

<sup>162</sup> *Id.* at 466.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* at 468.

<sup>165</sup> *Id.*

<sup>166</sup> See Bagley, *supra* note 55, at 379-83.

<sup>167</sup> E.g., Audrey Gilmore, David Carson & Aodheen O'Donnell, *Small Business Owner-Managers and their Attitude to Risk*, 22 MKTG INTEL. & PLANNING 3 (2004); Abbas J. Ali, *Decision-Making Style, Individualism, and Attitudes toward Risk of Arab Executives*, 23 INT'L STUD. MGMT. & ORG. 53 (1993).

<sup>168</sup> Cf. King, *supra* note 89, at 167 ("Interfirm [causal] ambiguity may deter a competitor from even attempting to imitate a competency because decision makers may fail to recognize the value of the competency or, in recognizing its value, may choose not to imitate it because of the risk involved in attempting to do what they recognize they do not know.").

<sup>169</sup> Steven Garber, *Product Liability, Punitive Damages, Business Decisions and Economic Outcomes*, 1998 WIS. L. REV. 237, 250 ("[W]hen decisionmakers consider liability risk they often substantially overestimate it. Contributing to this are high-visibility liability episodes such as unusually large awards, punitive damages, and liability when injury causation is disputed by respected authorities."). This causes managers to overestimate the risks of liability because widely reported cases of large damage awards give a distorted perception of the exposure caused by litigation. Robert S. Peck, *Tort Reform's Threat to an Independent Judiciary*, 33 RUTGERS L.J. 835, 841 n.18 (2002). See also Caroline H. Bledsoe et al., *Regulating Creativity: Research and Survival in the IRB Iron Cage*, 101 N.W. U. L. REV. 593, 608 (2007) (describing

passage of disability laws protecting employees triggered a decrease in fixed asset spending by firms apparently taking a wait-and-see approach to the new law.<sup>170</sup> Although disability law can influence fixed asset spending due to changes in physical plant to accommodate disabled workers, the approximately eleven percent drop in spending (\$1,878 per employee) was out of proportion to other studies' estimated costs of disability accommodations (average cost of an accommodation \$121.42).<sup>171</sup> Similarly, another study found that managers reacted to the adoption of wrongful discharge laws<sup>172</sup> as if the cost of exposure were one-hundred times as great as the actual legal costs.<sup>173</sup> The authors credit this response in part to an irrationally large fear of litigation encouraged by those who financially benefit from an increased deployment of defensive measures.<sup>174</sup>

Similar misconceptions regarding the impact of employment laws by employers were reported in another study. Managers have a strong incentive to avoid legal risks, even those that might present opportunities. Legal controversies will inevitably reflect poorly on the manager's decision-making ability and overall competence.<sup>175</sup> Risk tolerance may thus be associated with a propensity towards strategic legal action. Conversely, the systematic over-estimation of liability may inhibit strategic legal thinking. There is a robust source of attitudes from which to divine source of legal strategy.

#### *B. Attributive Variables: Size, Leadership, and Legal Staffing of the Firm*

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the rise of bureaucracy as created in part by 'goal displacement' whereby "managers intentionally overestimate risk to create wide margins of safety in order to avoid inefficiency and avert costly accidents. Instituted as precautionary measures in the forms of additional rules and insistence on strict adherence to the formalized procedures of the organization, these margin-of-safety measures, originally intended to ensure that the organization's goals are met, become the overriding concern." (citing ROBERT K. MERTON, *SOCIAL THEORY AND SOCIAL STRUCTURE: TOWARD THE CODIFICATION OF THEORY AND RESEARCH* 200 (1957)).

<sup>170</sup> Robert C. Bird & John D. Knopf, *Do Disability Laws Impair Firm Performance?*, available at <http://ssrn.com/abstract=1260899>. The study defined fixed assets as tangible, long-term assets that are used in firm operations over a period of years and not acquired for resale, such land, vehicles, buildings, office equipment, furniture, computers, and machinery. *Id.* at 20.

<sup>171</sup> *Id.* at 21-22 (citing Peter David Blanck, *COMMUNICATING THE AMERICANS WITH DISABILITIES ACT, TRANSCENDING COMPLIANCE: 1996 FOLLOW-UP REPORT ON SEARS, ROEBUCK AND CO.* (Annenberg Washington Program Reports, 1996). This report is available at <http://www.annenberg.northwestern.edu/pubs/sears>). Other studies predict varying costs. One reports that only one-percent of accommodations cost between \$500 and \$1,000 while another concluded that the average cost of accommodation was \$930. *Id.* at 22-23.

<sup>172</sup> Wrongful discharge laws provide protections to employees from firing on various grounds, including for reasons of public policy, found in an implied contract, or in contravention of good faith principles. See generally Robert C. Bird, *Rethinking Wrongful Discharge: A Continuum Approach*, 73 U. CIN. L. REV. 517 (2004).

<sup>173</sup> JAMES N. DERTOUZOS & LYNN A. KAROLY, *LABOR-MARKET RESPONSES TO EMPLOYER LIABILITY* xi, xiii (1992). See also Cynthia L. Estlund, *How Wrong are Employees About Their Rights, and Why Does it Matter?*, 77 N.Y.U. L. REV. 6, 11 (2002) (discussing these findings).

<sup>174</sup> DERTOUZOS & KAROLY, *supra* note 173, at 36-37. See generally Lauren B. Edelman et al., *Professional Construction of Law: The Inflated Threat of Wrongful Discharge*, 26 LAW & SOC'Y REV. 47 (1992) (exploring possible explanations for the striking disparity between the actual threat and the perceived threat posed by wrongful discharge lawsuits).

<sup>175</sup> DERTOUZOS & KAROLY, *supra* note 173, at 37.

In addition to a variety of attitudinal variables, attributive variables may promote strategic behavior. Put simply, a firm attribute is a characteristic of an organization or of the people employed by it.<sup>176</sup> For example, while a belief that lawyers impede change is an attitude, the number of lawyers in a company is an attribute. Firm attributes, like attitudes, have been the subject of significant study. For example, attributes of upper management have already been examined in relation to strategic orientation,<sup>177</sup> strategic change,<sup>178</sup> creativity,<sup>179</sup> firm performance,<sup>180</sup> and internationalization.<sup>181</sup> Attributes of organizations such as size of teams,<sup>182</sup> size of the firm,<sup>183</sup> innovative activity,<sup>184</sup> and workplace flexibility<sup>185</sup> have all been studied for their impact on firm performance. Just as attributes can impact a variety of firm measures, so can they likely influence whether a firm pursues a legal strategy.

There are many possible attributes worthy of study, but one of the most promising is the impact of a lawyer-CEO leading the organization. Overcoming a prejudice that lawyers make bad corporate executives, attorneys have shown to be dynamic and persistent leaders. As of December, 2004, 54 S&P 500 companies were led by CEOs with law degrees, inviting a comparison between lawyer and non-lawyer CEOs in their use of law as a strategic resource.<sup>186</sup> The obvious implication is that when a lawyer leads an organization he or she will be better able to integrate legal and business goals than an executive without legal training. Lawyers have led companies that have both succeeded

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<sup>176</sup> The definition of an attribute can be much more sophisticated. See, e.g., Ralph L. Keeney & Robin S. Gregory, *Selecting Attributes to Measure the Achievement of Objectives*, 53 OPERATIONS RES. 1 (2005). The article discusses the importance of attribute selection and identifying three different types of attributes: natural attributes, constructed attributes, and proxy attributes. *Id.* at 2. The article also notes that desirable attributes should be unambiguous, comprehensive, direct, operational, and understandable. *Id.* at 3. Such parsing, although no doubt useful in the right situation, is not necessary here.

<sup>177</sup> See Rajeswararao Chaganti & Rakesh B. Sambharya, *Strategic Orientation and Characteristics of Upper Management*, 8 STRAT. MGMT. J. 393 (1987) (examining external recruitment of managers and their functional background).

<sup>178</sup> See Warren Boeker, *Strategic Change: The Influence of Managerial Characteristics and Organizational Growth*, 40 ACAD. MGMT. J. 152 (1997) (exploring tenure of managers and heterogeneity).

<sup>179</sup> See Karen A. Bantel & Susan E. Jackson, *Top Management and Innovations in Banking: Does the Composition of the Top Team Make a Difference?*, 10 STRAT. MGMT. J. 107 (1989) (examining age, tenure, education level, firm size, and firm location).

<sup>180</sup> See Alan I. Murray, *Top Management Group Heterogeneity and Firm Performance*, 10 STRAT. MGMT. J. 125 (1989) (examining heterogeneity of managers by reviewing age, tenure, occupational diversity, and educational diversity).

<sup>181</sup> See Caligiuri et al., *supra* note 119.

<sup>182</sup> Monika Sharma & Anjali Ghosh, *Does Team Size Matter? A Study of the Impact of Team Size on the Transactive Memory System and Performance of IT Sector Teams*, 14 S. ASIAN J. MGMT. 96 (2007).

<sup>183</sup> Nermin Ozgulbas, Ali Serhan Koyuncugil & Fikriye Yilmaz, *Identifying the Effect of Firm Size on Financial Performance of SMEs*, 6 BUS. REV. 162 (2006).

<sup>184</sup> Weijun He & Ming Nie, *The Impact of Innovation and Competitive Intensity on Positional Advantage and Firm Performance*, 14 J. AM. ACAD. BUS. 205 (2008).

<sup>185</sup> Angel Martínez Sánchez et al., *Teleworking and Workplace Flexibility: a Study of Impact on Firm Performance*, 36 PERSONNEL REV. 42 (2007).

<sup>186</sup> Mike France & Louis Lavelle, *A Compelling Case for Lawyer-CEOs*, BUS. WEEK, Dec. 13, 2004, at 88, 88.

and failed, but lawyer-CEO's may help firms better recognize and address controversial issues such as corporate governance, ethics, and social responsibility.<sup>187</sup>

Another promising variable is the structure of legal staffing. A firm with in-house counsel might be the most likely source of legally strategic behavior. In-house attorneys have a single client and regularly interact with top executives in the organization. They might participate in executive meetings, be exposed to business issues, and forge a closer position of trust than an outside counsel would. It is possible that in-house counsel switch employers less frequently than attorneys in private practice. An in-house counsel has probably lost his or her 'book' of clients that allow a lawyer to move from one firm to another. Therefore, in-house counsel might remain with one firm for a longer time than a private attorney, allowing more time for a relationship between the attorney and executives to thrive.

The result of this closer integration might be twofold. First, integration might enable in-house counsel to understand the firm's business issues more thoroughly and thereby offer legal advice that integrates itself more seamlessly with firm goals. Second, integration might cause top executives to rely on their in-house counsel departments for a broader range of problems. Whereas a call to an outside counsel might trigger costly billable time, consultation with in-house lawyers has no explicit transaction cost. Physical proximity between executive and lawyer may also encourage casual conversation and a better understanding of one another's abilities and goals.

This does not necessarily mean, of course, that firms employing exclusively outside counsel are unable to germinate legal strategy. Many law firms have experienced partners who have long-standing relationships with their business clients. Through these relationships a similar knowledge-sharing between attorney and manager can emerge. Lawyers learn their client's business and goals more thoroughly. Managers develop a more nuanced understanding of what lawyers can offer them in helping to make business decisions. The differential amongst firms with external counsel might be the frequency and nature to which this counsel is relied upon. Managers that rely on external counsel infrequently are less likely to develop a close relationship that would precipitate information exchange necessary for strategic behavior. Managers that call on external counsel only when litigation looms or regulators knock may never get the opportunity to perceive lawyers as more than expensive tools for damage control. Given the previously discussed survey showing that CEO's do not view their general counsel as reservoirs of strategy,<sup>188</sup> much work needs to be done in order to understand how to develop meaningful lawyer and CEO information exchange.

Another source of strategic behavior may be the large numbers of non-lawyers that populate middle management and whose job it is to address a myriad of legal and regulatory problems. For example, Pratt & Whitney is a division of United Technologies Corporation that designs, manufactures and services aircraft engines, industrial gas

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<sup>187</sup> *Id.*

<sup>188</sup> HEIDRICK & STRUGGLES INT'L, INC. & THE MINORITY CORP. COUNSEL ASS'N, *supra* note 151, at 2-3, 5.

turbines and space propulsion systems.<sup>189</sup> Pratt & Whitney has a legal services department that manages export or import compliance, patent writing, managing contracts, government compliance, standards of business ethics, environmental health and safety, and government sales.<sup>190</sup> Only half of the employees in the department are attorneys.<sup>191</sup> These employees, many of whom likely have undergraduate and graduate business degrees, might be in a good position to perceive and exploit business opportunities when legal and business issues intersect. While not every firm will be faced with the same regulatory expectations as an engine manufacturer, most companies employ non-lawyer managers who are tasked with complying and navigating a specific regulatory regime. From that obligation might arise strategic thinking about the legal environment.

The firm's level of regulatory scrutiny may also be a factor in explaining propensity for legal strategy. Some industries such as airlines, financial services, and utilities, are heavily regulated.<sup>192</sup> Experience with regulation may train executives to think creatively about the legal environment of their business. Managers may have to frequently negotiate with regulators, address complex new changes in the law, file reports that satisfy legal requirements, and minimize the burden of rules on company operations. This experience may encourage managers to view regulations multi-dimensionally. One of those dimensions might be to integrate law with a firm's strategic goals. By contrast, managers that interact sporadically with regulations or respond only when litigation threatens may view laws as inflexible and regulators as autocratic. A narrow view of law may prevent managers from perceiving opportunities in new regulations.

Genuine reliance on a corporate code such as a credo or statement of ethics might facilitate strategic thinking.<sup>193</sup> A corporate code is a statement of values developed by an organization for which employees should follow or aspire.<sup>194</sup> Credos can not only require employees to follow the law but commit themselves to principled business conduct, high

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<sup>189</sup> Pratt & Whitney, [www.pw.utc.com](http://www.pw.utc.com) (click on "About Us").

<sup>190</sup> Greg Fearn, International Trade Compliance at Pratt & Whitney (2008) (powerpoint presentation, on file with the author). Greg Fearn is a manager of export/import compliance in Pratt & Whitney's Legal Department.

<sup>191</sup> *Id.*

<sup>192</sup> France & Lavelle, *supra* note 186, at 88. See also J. K. Himmelreich, *A Compliance Office for Heavily Regulated Enterprises – A Best Practice Approach to Meeting US FDA Requirements*, 25 BT TECH. J. 41 (2007) (discussing how pharmaceutical firm compliance offices can implement best practices towards regulations, contractual requirements, and other policies and procedures); Richard S. Gruner, *General Counsel in an Era of Compliance Programs*, 46 EMORY L.J. 1113, 1144 (1997) ("Where a firm operates in a heavily regulated industry--e.g., nuclear power plant operation or medical device manufacturing – the company will need a particularly large amount of legal information covering the many regulations constraining the industry.").

<sup>193</sup> Contrast this behavior with firms who adopt codes of ethics for merely symbolic reasons, which one publication argued the vast majority of firms actually do. Gary R. Weaver, Linda Klebe Trevino & Philip L. Cochran, *Corporate Ethics Practices in the Mid-1990s: An Empirical Study of the Fortune 1000*, 18 J. BUS. ETHICS 283, 283 (1999).

<sup>194</sup> E.g., Mark S. Schwartz, *The Nature of the Relationship Between Corporate Codes of Ethics and Behavior*, 32 J. BUS. ETHICS 247 (2001) (defining code of ethics) Margaret Anne Cleek & Sherry Lynn Leonard, *Can Corporate Codes of Ethics Influence Behaviour?*, 17 J. BUS. ETHICS 619, 622 (1998) (same).

ethical standards, and respect for stakeholders.<sup>195</sup> For example, Johnson and Johnson relied on its credo to guide it through a potentially disastrous tampering of its flagship brand Tylenol. The firm's frank communication with the press and assumption of responsibility the credo demanded is widely credited with saving the brand and preserving its market leadership.<sup>196</sup>

Genuine engagement with a credo requires managers to address the legal environment in a more complex way than simple compliance. The firm must examine its own moral standards, express those standards in a public document, and apply those standards throughout the organization. Through incorporation of credo values, a firm might improve its performance via a 'doing good by doing well' strategy.<sup>197</sup> In that way, adherence to a code is a strategic approach to ethics, taking a potentially cumbersome set of rules and applying those rules to capture internal or external value.

Ethics, like law, can be ignored, avoided, or viewed as an obstacle for performance. Instead, some firms incorporate ethical behavior into business practices, using ethics to attract socially responsible investing and engage in social marketing of products.<sup>198</sup> Managers experienced with creating value from ethical standards might have a greater propensity to find value in legal regulations. The value capturing process is similar – discovering opportunities in rules that voluntarily or mandatorily control behavior. Ethical firms must self-examine and perceive standards as enabling, perceptions also helpful in thinking strategically about the law. An ethically savvy firm might become a legally strategic firm and capture value in ways that other firms could not readily perceive.

Other variables may also be promising. The size of a firm's corporate legal staff might encourage strategic thinking. The number of attorneys in top management positions may encourage a culture of open information exchange. The presence of attorneys on a firm's board of directors might increase legal sensitivity in board decisions.<sup>199</sup> A highly competitive market environment may increase the motivation for a firm to search for new sources of competitive advantage.

Although rich opportunities exist, empirical research in this emerging area faces challenges. Any exploration of legal strategy must control for a number of variables including economic factors, labor factors, industry factors and firm-specific shocks. Any effort to isolate a strategic legal plan must account for other firm-wide or discipline-wide strategic initiatives occurring either concurrently or having recently occurred in the

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<sup>195</sup> Bird, *supra* note 99, at 171 (describing nature and function of various corporate codes).

<sup>196</sup> E.g., David Collins, *A Lesson in Social Responsibility: Corporate Response to the 1980s Tylenol Tragedies*, 27 VT. L. REV. 825 (2003) (describing Johnson and Johnson's response to the tampering). David Collins was a member of the strategy committee that managed the Tylenol crisis. *Id.* at 826.

<sup>197</sup> Some studies, though by no means all, find that evidence of corporate values are positively correlated with firm performance. E.g., Han Donker, Deborah Poff & Saif Zahir, *Corporate Values, Codes of Ethics, and Firm Performance: A Look at the Canadian Context*, 82 J. BUS. ETHICS 527 (2008).

<sup>198</sup> Bird, *supra* note 99, at 177-78.

<sup>199</sup> See generally Patrick W. Straub, *ABA Task Force Misses the Mark: Attorneys Should not be Discouraged from Serving on their Corporate Clients' Board of Directors*, 25 DEL. J. CORP. L. 261 (2000); Craig C. Albert, *The Lawyer-Director: An Oxymoron?*, 9 GEO. J. LEGAL ETHICS 413, 415 (1996).

company. The purpose of such controls would be to ensure that it is the legally-based resource that is the source of the resulting advantage and not a variety of other factors simultaneously influencing the firm's development. In spite of these challenges, the potential sources of strategic legal behavior are nearly as large as the varying legal attributes of a firm and remain an attractive topic for development.

### III. CONCLUSION

Law can be a source of sustainable competitive advantage—satisfying each element of the four-part test for sustainable competitive advantage: value, rarity, inimitability, and non-substitutability. Laws confer significant value to firms through the protection of innovation, the enabling of free labor markets, and the efficient regulation of contracts. Some legal resources are also rare, such as the benefits conferred through individual contracts between buyers and suppliers, manufacturers and customers, and labor and management. The competitive advantage of legal resources may be sustained by virtue of their imperfect limitability, their causal ambiguity, and their social complexity. Finally, substitutes for laws are rare and costly to obtain. This does not mean that all legal resources may convey a sustainable advantage, but it does indicate that a firm's legal environment may present opportunities for capturing sustainable advantages over rivals.

The notion that law can be used to create sustainable competitive advantage invites intriguing opportunities for further research. Little is known about managerial attitudes towards the law and our legal system. Already evidence exists that some managers vastly overestimate the costs of wrongful discharge laws and view lawyers with disdain. A future researcher may find a surprising level of ignorance or even animus toward lawyers and legal regulation in a wide variety of business subfields. Researchers may also find that CEOs undervalue their general counsel. With only four percent of surveyed CEOs reporting that strategic thinking would be a skill sought in a new general counsel, it is possible that many CEO-general counsel relationships lack the strategic partnership element that is so common amongst firm leaders and their marketing, financial, technology, and management arms. Until studies are undertaken to examine the effect of firm attributes, managerial attitudes, and attorney-CEO partnerships on the strategic successes of the organization, this promising stream of scholarship will remain untapped.

Academic pontifications notwithstanding, there is no clearer expression of the importance of legal strategy than that given by Larry Downes in the *Harvard Business Review*:

Your company's legal department is broken. At best it is an expensive bit of overhead, an evil made necessary by our litigious society. At worst, it is your biggest roadblock to innovation. In most organizations the legal staff is isolated and paid too much just to say no to the most interesting ideas and strategies. . . . The new corporate counsels must act as coach, adviser, and strategist, embracing their companies' most innovative plans. . . . Fifteen years ago, another member of the executive team stood in

comparable disregard, his value a matter of doubt. That person was the CIO. We all know how that turned out.<sup>200</sup>

Law is the information technology of the 21st century – a veritable “black box” of untapped competitive advantage.<sup>201</sup> Viewing law as a strategic resource can enable firms to ‘unbreak’ their legal departments and capture sustainable competitive advantages that rivals are unable or unwilling to pursue.

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<sup>200</sup> Larry Downes, *First, Empower All the Lawyers*, HARV. BUS. REV., Dec. 2004, at 19, 19.

<sup>201</sup> *Id.*

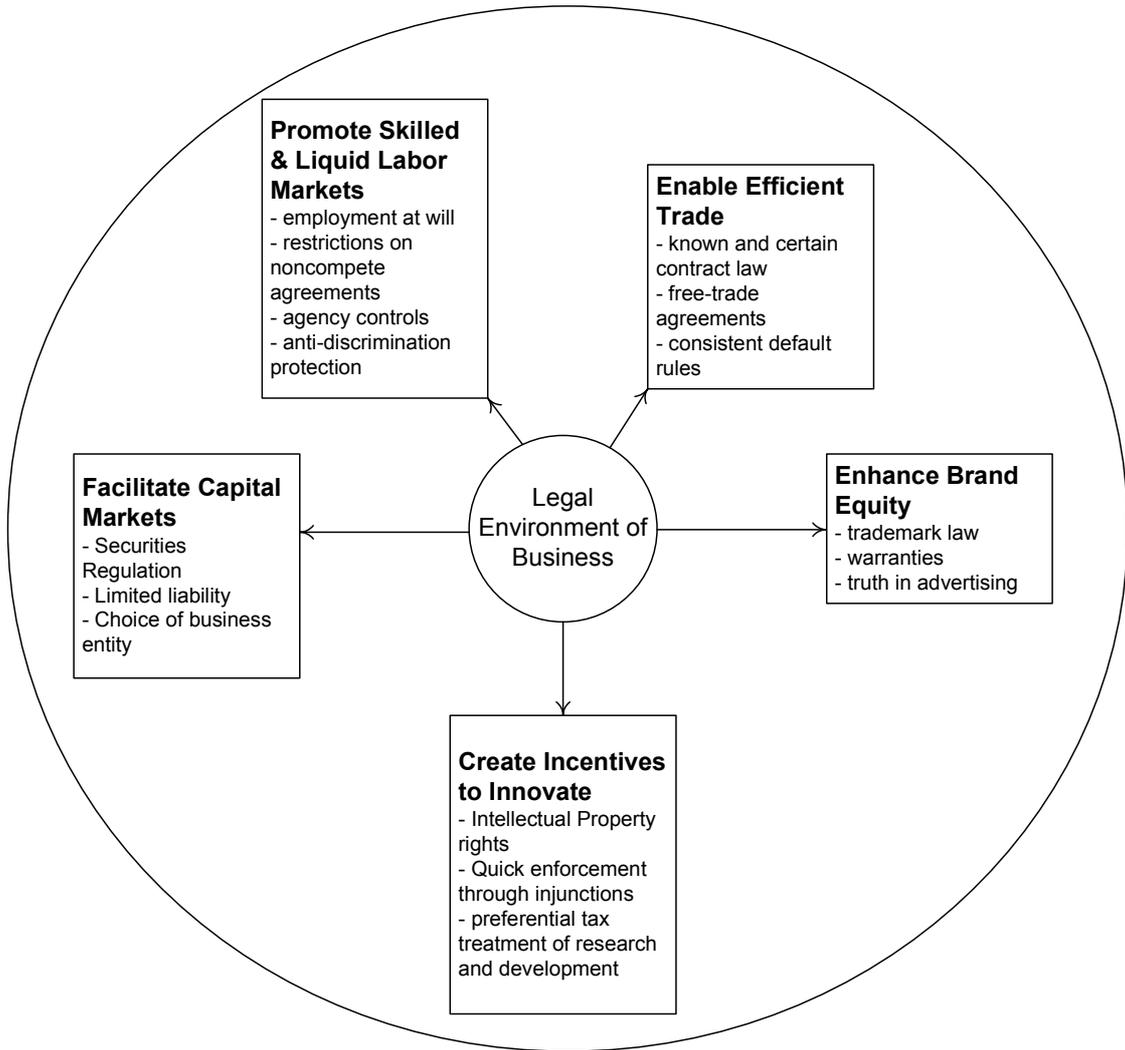


Exhibit 1: How the Legal Environment Facilitates Business Goals  
Adapted in part from Bagley (2005)

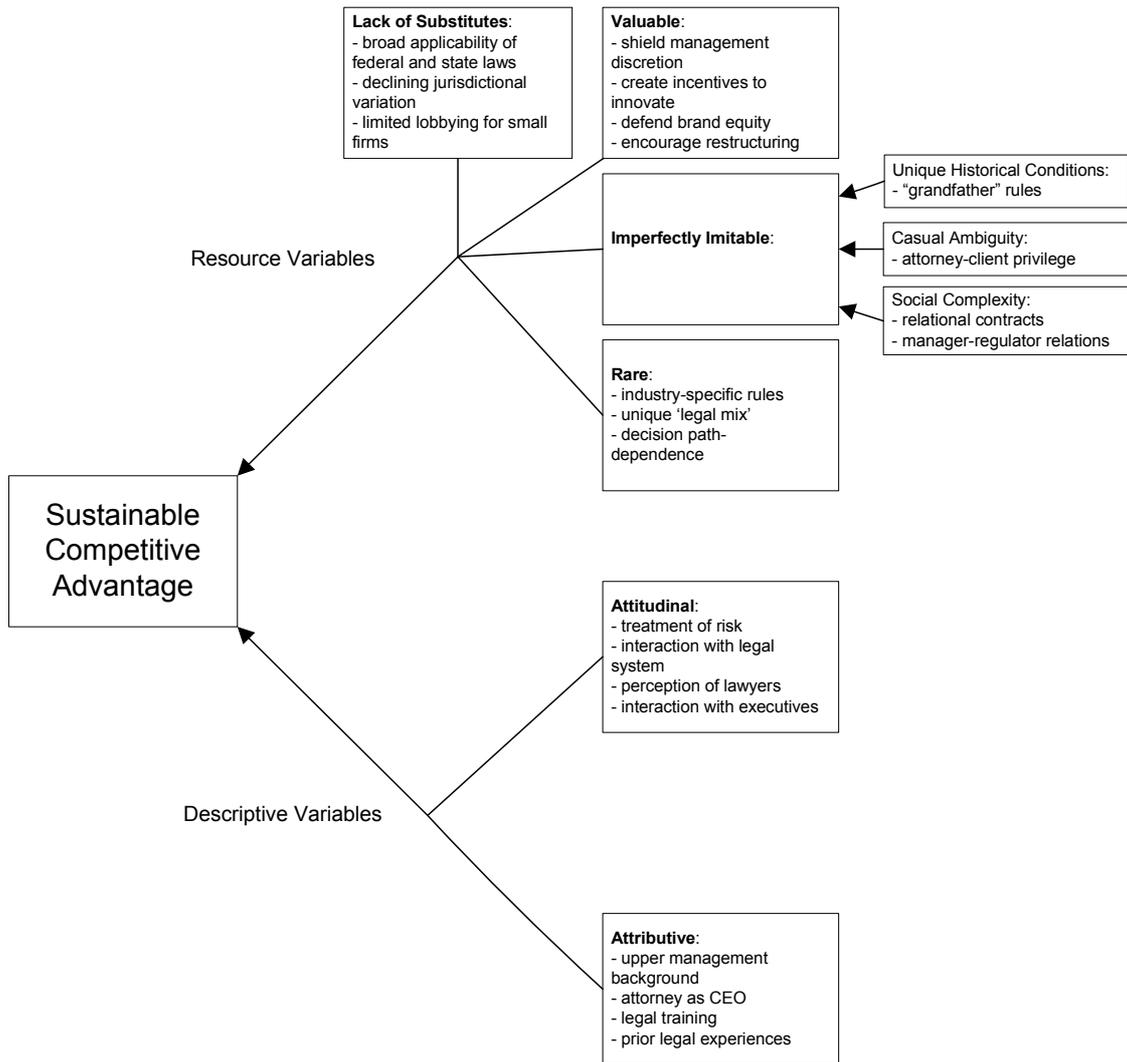


Exhibit 2: Sustainable Competitive Advantage:  
Resource and Descriptive Prerequisites