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Law, Strategy, and Competitive Advantage

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Law, Strategy, and Competitive Advantage

ROBERT C. BIRD

Firms aggressively seek a competitive advantage over rivals. A voluminous body of strategy scholarship has identified numerous sources of competitive advantage. Yet, the notion that law may be a source of competitive advantage remains largely unexplored. This is surprising given the significant time and resources managers dedicate to legal issues. This Article examines whether legal resources can generate a sustainable competitive advantage for firms. This Article also identifies firm attributes and managerial attitudes that might encourage legally strategic thinking. This Article concludes that law can be a source of a sustainable competitive advantage and that numerous variables exist worthy of future study.

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Law, Strategy, and Competitive Advantage

ROBERT C. BIRD*

I. INTRODUCTION

Firms continuously seek a competitive advantage over rivals.¹ Identifying sources of competitive advantage has long interested strategy theorists.² Scholars have identified competitive advantage opportunities in most business-related disciplines, including marketing,³ accounting,⁴ human resources,⁵ and management.⁶ Scholars have also studied

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¹ See GEORGE J. SIEDEL & HELENA HAAPIO, PROACTIVE LAW FOR MANAGERS 3–4 (2011); James W. Busbin et al., *The Evolution of Sustainable Competitive Advantage: From Value Chain to Modular Outsource Networking*, 6 COMPETITION F. 103, 103–04 (2008) (defining competitive advantage and discussing different strategies to achieve this advantage).

² See, e.g., 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.”); David J. Teece et al., *Dynamic Capabilities and Strategic Management*, 18 STRATEGIC MGMT. J. 509, 509 (1997) (“The fundamental question in the field of strategic management is how firms achieve and sustain competitive advantage.”).

³ See, e.g., Sundar G. Bharadwaj et al., *Sustainable Competitive Advantage in Service Industries: A Conceptual Model and Research Propositions*, 57 J. MARKETING 83, 83 (1993).

⁴ See, e.g., 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, 402 (2004) (conducting a study that analyzes the impact of competitive advantage on product life cycle cost analysis).

⁵ See, e.g., Sugio Baba, *Remodelling Employment for Competitive Advantage: What Will Follow Japan’s ‘Lifetime Employment’?*, 3 ASIAN BUS. & MGMT. 221, 228 (2004) (“In order to acquire superiority in terms of employees, it is better to develop them internally than acquire them from the open market.”); Augustine A. Lado & Mary C. Wilson, *Human Resource Systems and Sustained Competitive Advantage: A Competency-Based Perspective*, 19 ACAD. MGMT. REV. 699, 699 (1994) (“The resource-based view suggest that human resource systems can contribute to sustained competitive advantage. . .”).

⁶ See, e.g., Riccardo Silvi & Suresh Cuganesan, *Investigating the Management of Knowledge for Competitive Advantage: A Strategic Cost Management Perspective*, 7 J. INTELL. CAPITAL 309, 310–11 (2006) (“Within strategic management . . . the focus has recently been on the comprehension of ‘what’

competitive advantage from cross-functional perspectives such as organizational capital,⁷ human capital,⁸ and global competition.⁹ The result has been a voluminous literature on improving firm strategy.

In spite of these efforts, the notion that law may be a source of competitive advantage remains largely unexplored.¹⁰ This is especially noteworthy given that legal issues may require as much as twenty-five percent of a CEO's time.¹¹ According to approximately 900 surveyed business executives attending a management development program, law ranked third only to human resources and finance as a valuable discipline.¹² Recent demands for increased corporate regulation pursuant to the Sarbanes-Oxley Act of 2002,¹³ the increased demand for legal compliance programs,¹⁴ and the widespread use of litigation as a tool for business reform,¹⁵ have increased firm's regulatory obligations. Legal issues may be one of the most important determinants in a firm's external operating environment.¹⁶ Law is likely the last great source of untapped

an organization currently knows, 'what' it needs to know in order to be competitive and 'how' it should align its capabilities to those ones required.").

⁷ Gregorio Martín-de-Castro et al., *Organizational Capital as Competitive Advantage of the Firm*, 7 J. INTELL. CAPITAL 324, 329 (2006).

⁸ Nile W. Hatch & Jeffrey H. Dyer, *Human Capital and Learning as a Source of Sustainable Competitive Advantage*, 25 STRATEGIC MGMT. J. 1155, 1155-56 (2004).

⁹ Hao Ma, *Toward Global Competitive Advantage: Creation, Competition, Cooperation, and Co-Option*, 42 MGMT. DECISION 907, 911-18 (2004).

¹⁰ Cf. Larry Downes, *First, Empower All the Lawyers*, HARVARD 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). For a notable exception dedicating an entire issue to questions of law and strategy, see Daniel R. Cahoy, *Editors Corner: Assembling a Special Issue on Law as a Source of Strategic Advantage*, 47 AM. BUS. L.J. v, v (2010). I was grateful for the invitation to contribute a Foreword to this issue in order to briefly survey the field and offer new directions for further research. Robert C. Bird, *The Many Futures of Legal Strategy*, 47 AM. BUS. L.J. 575, 575-77 (2010).

¹¹ 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*].

¹² Siedel, *Six Forces*, *supra* note 11, at 727.

¹³ See Stephen Wagner & Lee Dittmar, *The Unexpected Benefits of Sarbanes-Oxley*, HARV. BUS. REV., Apr. 2006, at 133-134 (discussing the burdens of increased corporate regulation placed upon firms by the Sarbanes-Oxley Act of 2002).

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

¹⁵ Wendy Wagner, *When All Else Fails: Regulating Risky Products Through Tort Litigation*, 95 GEO. L.J. 693, 695 (2005) ("[T]he tort system can be more effective than the regulatory system in accessing the various types of information needed to inform regulatory decisions.").

¹⁶ See, e.g., SIEDEL & HAAPIO, *supra* note 1, at 2; 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*].

competitive advantage.¹⁷

This Article bridges the divide between management and legal literature by accomplishing two goals. First, Part II of this article examines whether the legal environment can produce the most sought after type of competitive advantage—a long-term sustainable one that rivals cannot easily imitate. After concluding that law is an abundant source of sustainable competitive advantage, Part III of this Article hypothesizes 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.

II. 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.¹⁸ At its core, the resource-based view posits that firms may obtain sustainable competitive advantage by focusing on strategies that leverage their internal resources to take advantage of environmental opportunities.¹⁹ Whereas strategic management research focuses on isolating and addressing a firm's external opportunities and threats,²⁰ resource-based research develops frameworks

¹⁷ Downes, *supra* note 10, at 19.

¹⁸ See Birger Wernerfelt, *The Resource-Based View of the Firm: Ten Years After*, 16 STRATEGIC MGMT. J. 171, 172 (1995) ("The resource-based view started as my attempt to satisfy myself that one could build a consistent foundation for the classic theory of business policy."); Birger Wernerfelt, *A Resource-Based View of the Firm*, 5 STRATEGIC MGMT. J. 171, 171 (1984) ("Looking at economic units in terms of their resource endowments has a long tradition in economics.").

¹⁹ 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 (internal 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 STRATEGIC MGMT. J. 121, 121 (2007).

²⁰ See, e.g., MICHAEL PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE xv (1985) (discussing competitive advantage with global competitors); MICHAEL PORTER, COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS ix (1980) ("Competitive strategy is an area of primary concern to managers, depending critically on a subtle understanding of industries and competitors."); Robert Grant, *The Resource-Based*

that define characteristics that resources must possess in order to confer a strategic advantage.²¹

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

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.²⁵ Another scholar concluded that firm efforts to obtain competitive advantage had a positive impact on the use of product life cycle cost controls.²⁶ Scholars have also used the resource-based view to examine the impact of the unit cost of manufacturing, fast delivery, volume change flexibility, inventory turnover, and cycle time on a firm's competitive advantage.²⁷ Other scholars developed and applied a cost-knowledge management framework that examined the impact of knowledge management practices on competitive advantage.²⁸ This scholarship has also explored the ability of a firm to turn its human resource systems,²⁹ organizational capital,³⁰ or interconnectedness with other firms³¹ into a competitive advantage. The resource-based view is considered "one of the most influential frameworks

Theory of Competitive Advantage: Implications for Strategy Formulation, CAL. MGMT. REV., Spring 1991, at 114, 114 ("Strategy has been defined as 'the match an organization makes between its internal resources and skills . . . and the opportunities and risks created by its external environment.'").

²¹ 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, 221 (2003).

²² Ingemar Dierickx & Karel Cool, *Asset Stock Accumulation and Sustainability of Competitive Advantage*, 35 MGMT. SCI. 1504, 1507-09 (1989).

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

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

²⁵ Bharadwaj et al., *supra* note 3, at 88-93.

²⁶ Dunk, *supra* note 4, at 411.

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

²⁸ Silvi & Cuganesan, *supra* note 6, at 314-19.

²⁹ Lado & Wilson, *supra* note 5, at 699.

³⁰ Martín-de-Castro et al., *supra* note 7, at 324, 325.

³¹ Lavie, *supra* note 24, at 638.

of the strategic management literature.”³²

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.³³ This research addresses the influence of government institutions on firm behavior³⁴ as well as efforts to change government policy.³⁵

The law and strategy research that is the focus of this Article is distinct from the study of corporate political activity.³⁶ Corporate political activity focuses on firm attempts to shape government policy. By contrast, law and

³² *Id.* at 640. Some scholars have called the resource-based view an entirely new theory of the firm. See Clulow et al., *supra* note 21, at 221 (discussing the early foundation of the theory and the need for further development); Kathleen R. 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) (noting the historic impact of the resource-based approach).

³³ See, e.g., John C. Aplin & W. Harvey Hegarty, *Political Influence: Strategies Employed by Organizations To Impact Legislation in Business and Economic Matters*, 23 ACAD. MGMT. J. 438, 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 STRATEGIC MGMT. J. 175, 176–78 (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., Kathleen A. Getz, *Research in Corporate Political Action*, 36 BUS. & SOC. 32, 32–50 (1997) (reviewing the literature addressing corporate political action strategies); Amy J. Hillman et al., *Corporate Political Activity: A Review and Research Agenda*, 30 J. MGMT. 837, 847–50 (2004) (reviewing the literature in the field since 1995); Brian Shaffer, *Firm-Level Responses to Government Regulation: Theoretical and Research Approaches*, 21 J. MGMT. 495, 495–510 (1995) (tracing the development of various theoretical perspectives on business-government relation strategies).

³⁴ See David P. Baron, *Integrated Strategy: Market and Nonmarket Components*, CAL. MGMT. REV., Winter 1995, at 47, 47 (arguing that approaches to strategy formulation must integrate market and nonmarket considerations).

³⁵ See JOHN F. MAHON & RICHARD A. MCGOWAN, *INDUSTRY AS A PLAYER IN THE POLITICAL AND SOCIAL ARENA: DEFINING THE COMPETITIVE ENVIRONMENT* 195–97 (1996) (noting that industries work to confront government policy through outreach and interest groups, but concluding that they should do even more).

³⁶ Shaping government policy, though important, is not a technique that can be successfully practiced by every firm. As I expressed in an earlier article: “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 is that not all firms can influence their legal environment. Many firms, particularly small companies and start-ups, lack the resources or 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 including a firm’s competitors, thereby negating 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.” Robert C. Bird, *Pathways of Legal Strategy*, 14 STAN. J.L. BUS. & FIN. 1, 6–7 (2008).

strategy research examines the ability of managers to extract competitive advantage in a legal environment that is already established. This latter stream of research is underdeveloped and holds significant promise.

One example is a 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.³⁷ Hinthorne applied this concept to the airline 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.³⁸ Hinthorne concluded that “lawyers and corporate leaders who understand the law . . . have a unique capacity to protect and enhance share-owner wealth.”³⁹

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.⁴⁰ James Holloway developed a legal-managerial analysis framework to aid in management decision-making of legal decisions.⁴¹ This framework advocates a common thinking and understanding of legal and management problems and encourages firms to implement decisions in a coordinated fashion.⁴² Constance Bagley presented an examination of the various legal dimensions involved in managerial decision-making through a case study.⁴³ Bagley recommends that a firm’s legal strategy and business strategy should be consistent with one another.⁴⁴

³⁷ Tom Hinthorne, *Predatory Capitalism, Pragmatism, and Legal Positivism in the Airlines Industry*, 17 STRATEGIC MGMT. J. 251, 251 (1996).

³⁸ *Id.* at 251–52.

³⁹ *Id.* at 254.

⁴⁰ See Siedel, *Six Forces*, *supra* note 11, at 734.

⁴¹ 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, 133 (2002) (exploring how the “genesis of a theory of law and business would affect the managerial entry and utility of law and public policy in business decision-making”).

⁴² *Id.*

⁴³ See CONSTANCE E. BAGLEY & DAVID LANE, X-IT AND KIDDE (A), Case No. 9-803-041 (Harvard Business School ed., May 20, 2003) (presenting and examining managerial decision-making by X-IT, a startup ladder-making company).

⁴⁴ *Id.*; see also Constance E. Bagley, *What’s Law Got to Do With It?: Integrating Law and Strategy*, 47 AM. BUS. L.J. 587, 588–90 (2010) (“[A] failure to comply with applicable laws can subject a firm to crushing government fines and ruinous damage awards and put its top executives in prison, [therefore] any discussion of law and strategy must begin with the baseline of what is illegal behavior.”).

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.⁴⁵ He suggested that managers “climb to the balcony” to reframe legal issues as business concerns.⁴⁶ Applying this concept to a variety of legal topics, he noted that regulation often presents an opportunity for competitive advantage and should be viewed as more than just a cost of doing business.⁴⁷ Similarly, Bagley thoughtfully encouraged managers to treat their lawyers as strategic partners in decision-making.⁴⁸ Bagley focused on using law as a mechanism for capturing value and reducing risk.⁴⁹

In an earlier article, I classified the legal strategic behavior of firms into five pathways.⁵⁰ “Avoidance” firms are defined as those that view regulations as costly and senseless obstacles to be evaded whenever possible.⁵¹ While “compliance” firms seek only to follow the law as written, “prevention” firms implement business approaches to anticipate future legal problems.⁵² “Advantage” firms equate the strategic relevance of the legal environment with other business disciplines.⁵³ Finally, the rare “transformation” firm succeeds in using the legal environment to redefine a core mission or aspect of the organization.⁵⁴

In 2008, Bagley published an important article on the value of legal astuteness.⁵⁵ 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 skill that enhances firms.⁵⁶ 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.⁵⁷ Legal astuteness is also established through a proactive approach to regulation, an exercise of thoughtful judgment toward legal opportunities, and possession of legal literacy.⁵⁸ Legally astute managers

⁴⁵ SIEDEL, COMPETITIVE ADVANTAGE, *supra* note 16, at 6–7.

⁴⁶ *Id.* at 24–25.

⁴⁷ *Id.* at 25.

⁴⁸ 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).

⁴⁹ *Id.* at 1–2, 9–12.

⁵⁰ Bird, *supra* note 36, at 4.

⁵¹ *Id.* at 12–17.

⁵² *Id.* at 17–26.

⁵³ *Id.* at 26–31.

⁵⁴ *Id.* at 31–37.

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

⁵⁶ *Id.*

⁵⁷ *Id.* at 379.

⁵⁸ *Id.* at 380–82.

can apply their skills to capture value by using formal contacts to strengthen relationships and reduce transaction costs, protecting and enhancing the value of firm resources, creating options through contracts, and converting regulatory restraints into opportunities.⁵⁹ The article concludes that by having legal astuteness, top management teams can capture competitive advantages for their firms.⁶⁰ A summary of how the legal environment facilitates business goals is illustrated in Exhibit 1.

Most recently, George Siedel and Helena Haapio published their book, *Proactive Law for Managers*.⁶¹ Directed toward managers who lead organizations, this text systematically explores how competitive advantages can be extracted from legal resources.⁶² Chapters canvass strategic opportunities in products liability, employment, intellectual property, contracts, environmental law and business ethics.⁶³

This book is especially useful not only because of its substantive information about strategy, but also because of its method. The book introduces a decision-making process called The Manager's Legal Plan (MLP). The MLP is structured with the manager, not the lawyer, in mind. The MLP enables managers to move from a reactive perception of the law to one that proactively uses legal resources.⁶⁴ Step one requires managers to understand the law.⁶⁵ As simple as it seems, managers must master the rules and regulations relevant to one's industry.⁶⁶ Step two advocates for a "fight or flight" response, whereby managers should decide whether to take action or leave the status quo in their organizations.⁶⁷ This stage also helps managers decide whether to defend a case in court or settle a dispute.⁶⁸

⁵⁹ *Id.* at 383.

⁶⁰ *Id.* at 387.

⁶¹ SIEDEL & HAPIO, *supra* note 1.

⁶² *Id.* at xvii.

⁶³ *See id.* at xviii.

⁶⁴ *Id.* at 13; *see also* George J. Siedel & Helena Haapio, *Using Proactive Law for Competitive Advantage*, 47 AM. BUS. L.J. 641, 651–56 (2010) (discussing the steps that help managers gain a competitive advantage). This article also explores the Proactive Law Movement (PLM), a future-oriented approach to law that anticipates legal problems and takes steps to prevent such problems from arising. *Id.* at 656–60. PLM has been popular among scholars in Europe. *Id.* at 656. Interestingly, it has been skillfully applied not just toward improving competitiveness of private entities, but also toward facilitating the responsiveness and legislative development of government agencies. For example, "the European Economic and Social Committee (EESC) adopted the proactive approach in an Opinion directed toward improving regulation in the European Union (EU)." *Id.* at 661. This movement offers significant possibilities and deserves closer attention by non-European scholars.

⁶⁵ SIEDEL & HAPIO, *supra* note 1, at 13.

⁶⁶ *Id.* at 13–14; *see also* David Orozco, *Legal Knowledge as an Intellectual Property Management Resource*, 47 AM. BUS. L.J. 687, 687–94 (2010) (discussing the importance of legal and managerial knowledge as a source of competitive advantage).

⁶⁷ SIEDEL & HAPIO, *supra* note 1, at 14.

⁶⁸ *Id.*

Step three recommends that managers develop strategies and solutions to prevent future legal problems.⁶⁹ For example, managers concerned about wrongful discharge litigation should think beyond court costs and proactively review the firm's policies relative to hiring, evaluation, and information disclosure.⁷⁰ While such recommendations may seem apparent to lawyers, for managers acting on their own in a legal context, they represent sound decisions that can prevent unnecessary value leakages. Finally, step four directly addresses proactivity.⁷¹ This final step of the MLP exhorts managers to climb "to the balcony" to see legal decisions in their broader business context.⁷² Managers should apply the law in this step to meet business goals such as strengthening customer relationships and protecting the integrity of commercial transactions. As the authors rightly note, "[l]aw is perhaps the most hidden of all competitive strategy tools. It is sometimes complex, and not all managers like to deal with it—or with lawyers."⁷³

As this Article shows, overall, 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 the legal environment in which all businesses operate. In spite of these welcome advances, the research on law and strategy still needs significant development. This next section applies a widely used 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?*

Competitive advantage is defined as a value-creating strategy using firm resources to improve a firm's efficiency or effectiveness in ways not in use by current or potential competitors.⁷⁴ 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.⁷⁵ Furthermore, not all advantages make

⁶⁹ *Id.* at 14–15.

⁷⁰ *Id.* at 15.

⁷¹ *Id.* at 15–16.

⁷² *Id.* at 15. The phrase evokes a theme in Professor Siedel's earlier book, which focused on seeing the law within its business perspective. See SIEDEL, *COMPETITIVE ADVANTAGE*, *supra* note 16, at 25.

⁷³ *Id.* at 16; see also Downes, *supra* note 10, at 19 ("In most organizations, the legal staff is isolated and paid too much just to say no to the most interesting ideas and strategies.").

⁷⁴ See 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").

⁷⁵ See *id.* (noting that not all firm resources confer strategic advantages and that some might even "prevent a firm from conceiving of and implementing valuable strategies").

firms more competitive. For example, 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.⁷⁶

Even if a firm establishes a competitive advantage, not all competitive advantages are sustainable. 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; attentive rivals may negate that benefit by incorporating the same technology. A firm's competitive advantage is therefore sustainable when it is not being implemented by rivals and other firms are unable to duplicate the strategy over the long-term.⁷⁷ Customers benefit from the practice directly through obtaining superior products or services or indirectly through buying products or services equivalent to rivals at lower prices.⁷⁸ 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 Jay Barney's four conditions.⁷⁹ According to Barney, and illustrated as part of Exhibit 2, a firm resource must possess four attributes before it can create a sustained competitive advantage—value, rareness, imperfect imitability, and the lack of an equal substitute. First, a firm resource must possess *value*.⁸⁰ Firm resources are valuable when they enable a firm to implement a strategy that will improve its efficiency or effectiveness.⁸¹ Valuable resources negate threats or enable opportunities depending upon the firm's position in its industry, and may also be a source of differentiation that firms can exploit.⁸²

⁷⁶ *Id.*

⁷⁷ See *id.* (“[W]hether or not a competitive advantage is sustained depends upon the possibility of competitive duplication.”).

⁷⁸ See Busbin et al., *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.”).

⁷⁹ See, 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. J. 13, 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 Intangible Assets*, 7 J. INTELL. CAPITAL 406, 411–14 (2006) (identifying and discussing law as an intangible asset).

⁸⁰ Barney, *supra* note 2, at 106.

⁸¹ *Id.*

⁸² Flatt & Kowalczyk, *supra* note 79, at 14.

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.⁸³ 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 tarnish. Laws prevent executives from publishing misleading information that might manipulate stock prices, and allow shareholders to rely on public information disbursed by firms with confidence.⁸⁴ Firms cannot sustain unsafe workplace practices in misguided efforts to improve productivity.⁸⁵

Laws also influence a firm's external environment. Liability statutes regulate the manufacture of products and environmental compliance procedures.⁸⁶ 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.⁸⁷ Finally, laws enable free and open labor markets through the prohibition of unwanted discrimination and enabling an employment-at-will default rule.⁸⁸ Thus, 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.⁸⁹ Barney explains that, at a minimum, the number of firms possessing the valuable resource must be "less than the number of firms needed to generate perfect competition dynamics in an industry."⁹⁰ If all firms possess the same resource, then exploitation of that resource by one firm can be readily copied by rivals,

⁸³ See Fred W. Triem, *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.").

⁸⁴ For laws responsible in part for the public disclosure requirements placed upon corporations, see the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2006), the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78nn (2006), 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. (2006)).

⁸⁵ See, e.g., the Occupational Safety and Health Act of 1970, 29 U.S.C. § 654 (2006).

⁸⁶ CONSTANCE E. BAGLEY, *WINNING LEGALLY: HOW TO USE THE LAW TO CREATE VALUE, MARSHAL RESOURCES, AND MANAGE RISK* 32-33 (2005).

⁸⁷ *Id.* at 30-31.

⁸⁸ *Id.* at 35-37.

⁸⁹ Barney, *supra* note 2, at 106.

⁹⁰ *Id.* at 107.

thereby negating the possibility of sustained competitive advantage.⁹¹

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.⁹² 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.⁹³ 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.⁹⁴ For example, a firm from the United States selling products 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.⁹⁵ 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.⁹⁶

⁹¹ *Id.* at 106.

⁹² See Julie C. Suk, *Procedural Path Dependence: Discrimination and the Civil-Criminal Divide*, 85 WASH. U. L. REV. 1315, 1323–25 (2008) (“[P]ath dependence occurs when a present outcome is shaped by the historical path leading up to it.”).

⁹³ 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, 578 (1999).

⁹⁴ See *supra* note 92 (explaining path dependence).

⁹⁵ See Farok J. Contractor, *Choosing Between Direct Investment and Licensing: Theoretical Considerations and Empirical Tests*, 15 J. INT’L BUS. STUD. 167, 167 (1984) (“The use of licensing to independent foreign companies as an overseas market-entry method is no longer an inconsequential strategy for American multinationals.”).

⁹⁶ Barney, *supra* note 2, at 105–06.

Barney articulates three sources of imperfectly imitable resources: (1) unique historical conditions (2) a causally ambiguous link between a firm's resources and its advantage, or (3) social complexities.⁹⁷ 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.⁹⁸ 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.⁹⁹ 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.¹⁰⁰ A Virginia banking law allows certain banks to operate insurance divisions if they were doing so by the early 1970s, even though such operations are illegal in Virginia today.¹⁰¹ 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.¹⁰² 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.¹⁰³ The purveyance of legal

⁹⁷ *Id.* at 107 (citing Dierickx & Cool, *supra* note 22, at 1504).

⁹⁸ See Heidi Gorovitz Robertson, *If Your Grandfather Could Pollute, So Can You: Environmental "Grandfather Clauses" and Their Role in Environmental Inequity*, 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).

⁹⁹ *Id.* at 152.

¹⁰⁰ Robert R. Devéza, *A Grandfather Clause, Due Process, and the GATT: Whatever Happened to the Grandfather Clause of the Process Patent Act of 1988?*, 18 RUTGERS COMPUTER & TECH. L.J. 65, 65–66 (1992).

¹⁰¹ Robertson, *supra* note 98, at 133 n.8.

¹⁰² James J. Hoffman et al., *Social Capital, Knowledge Management, and Sustained Superior Performance*, J. KNOWLEDGE MGMT., 2005, at 93, 94; 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).

¹⁰³ See, e.g., Scott R. Flucke, *The Attorney-Client Privilege in the Corporate Setting: Counsel's Dual Role as Attorney and Executive*, 62 U. MO. KAN. CITY L. REV. 549, 552, 557 (1994) ("Consistently applying the privilege to corporate clients is a fairly recent development in the law"); 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, 43–44 (2008) ("Under some circumstances, the law provides a personal attorney-client privilege for

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 in the files of company counsel. It is neither tangible nor fungible, and it is 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.

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.¹⁰⁴ Conditions such as employee loyalty or a culture of creativity can be difficult to analyze and replicate.¹⁰⁵ Social complexity can exist in the legal environment. For example, firms place a premium on having strong positive working relationships with regulatory authorities.¹⁰⁶ These relationships can have difficult-to-imitate characteristics, such as trust, shared commitment to goals, and mutual respect. If the firm violates a rule, a regulator that trusts firm management to not reoffend 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.¹⁰⁷

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

corporate executives. When that happens, the executive's communications with counsel remain confidential until the executive decides to reveal them.").

¹⁰⁴ Barney, *supra* note 2, at 110.

¹⁰⁵ *Id.*

¹⁰⁶ See, 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*, NAT. RESOURCES & ENV'T, Summer 1989, at 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").

¹⁰⁷ 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).

responding to bank regulator concerns over deficiencies in corporate governance.¹⁰⁸ Instead of dragging its feet, PNC Bank built a “best-in-class” governance and risk management model.¹⁰⁹ Based on the strong relationship it had forged with regulators, it received approval to complete a desired bank acquisition.¹¹⁰

Of course not every manager can build a personal relationship with government regulators. Managers do, however, have opportunities 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 for popularizing relational contract theory.¹¹¹ 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.¹¹² Such norms promote cooperative behavior between the contracting parties and inhibit opportunism.¹¹³ Firms in relational contracts pre-arrange dispute resolution mechanisms, make partner-specific capital investments, and incorporate flexibility for unexpected mishaps.¹¹⁴ Relationally-based business-to-business partners may maintain friendships, share experiences, or communicate about issues in the industry.¹¹⁵ 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.¹¹⁶ 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

¹⁰⁸ EDWARD D. HERLIHY ET AL., *THE EVOLVING LANDSCAPE OF FINANCIAL INSTITUTIONS M&A: AN ANALYSIS OF CURRENT TRENDS AND DEVELOPMENTS: AN ANNUAL REVIEW OF LEADING DEVELOPMENTS* 148–49 (2006).

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ IAN R. MACNEIL, *THE RELATIONAL THEORY OF CONTRACT: SELECTED WORKS OF IAN MACNEIL* (David Campbell ed., 2001).

¹¹² Robert C. Bird, *Employment as a Relational Contract*, 8 U. PA. J. LAB. & EMP. L. 149, 151 (2005).

¹¹³ *Id.* at 153; Richard E. Speidel, *The Characteristics and Challenges of Relational Contracts*, 94 NW. U. L. REV. 823, 829–30 (2000); see also SIEDEL & HAAPIO, *supra* note 1, at 110–11 (discussing conflict prevention and management in contracts); Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 AM. BUS. L.J. 727, 754–57 (2010) (discussing strategic collaboration).

¹¹⁴ Bird, *supra* note 112, at 153.

¹¹⁵ *Id.*

¹¹⁶ *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, 660 (1998) (discussing the competitive advantages that may be afforded to firms through different forms of interfirm partnerships).

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.¹¹⁷ Relational contracts between businesses may result in investments in relation-specific assets, an exchange of knowledge that mutually benefits all involved parties, the combination of complimentary and scarce resources, and the lowering of transaction costs.¹¹⁸ 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 equivalent substitutes*.¹¹⁹ According to Barney, if a rival can copy a firm's valuable and rare competitive resources through different but strategically equivalent means, that firm's competitive advantage will not be sustainable over the long term.¹²⁰

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 and state law. Firms cannot simply 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 alternatives when submitting to a legal regime, but the alternatives 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. Such action, however, runs the risk of being 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.¹²¹ Firms may also attempt to shape the common law.¹²² 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

¹¹⁷ Bird, *supra* note 112, 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, 367-68 (1994).

¹¹⁸ Dyer & Singh, *supra* note 116, at 661.

¹¹⁹ Barney, *supra* note 2, at 106.

¹²⁰ *Id.* at 111.

¹²¹ 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* 4-8 (2001).

¹²² 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.").

more difficult to win.¹²³ 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.¹²⁴ Through favorable corporate laws, Delaware skillfully positioned itself as the market leader for business entity formation.¹²⁵ Similarly, offshore banking institutions have attracted large quantities of assets from U.S. companies seeking favorable financial laws.¹²⁶

Yet, the substitutability of laws remains limited. 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, inter-jurisdictional advantages may converge over time.¹²⁷ 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.¹²⁸ In spite of 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.¹²⁹ 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.

¹²³ 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).

¹²⁴ Timothy P. Glynn, *Interjurisdictional Competition in Enforcing Noncompetition Agreements: Regulatory Risk Management and the Race to the Bottom*, 65 WASH. & LEE L. REV. 1381, 1382 (2008).

¹²⁵ See Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391 tbl.2, 392 tbl.3 (2003) (showing that Delaware receives approximately sixty percent of all publicly traded incorporations).

¹²⁶ Dale D. Murphy, *Interjurisdictional Competition and Regulatory Advantage*, 8 J. INT'L ECON. L. 891, 897–907 (2005).

¹²⁷ *Id.* at 916–18; see also SIEDEL & HAAPIO, *supra* note 1, at 7–10; SIEDEL, *COMPETITIVE ADVANTAGE*, *supra* note 16, at 17–18. Yet, evidence still exists that how a nation chooses to establish the rule of law still influences the growth of its market based economy. See David Silverstein & Daniel C. Hohler, *A Rule-of-Law Metric for Quantifying and Assessing the Changing Legal Environment of Business*, 47 AM. BUS. L.J. 795, 797 (2010).

¹²⁸ See 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 (1998) (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).

¹²⁹ Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1443 (1992).

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. Part III of this Article addresses this issue, exploring what conditions can most effectively create an environment where legally strategic behavior will thrive.

III. 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 innovation¹³⁰ and creativity,¹³¹ so too are the characteristics that might drive legally strategic behavior 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 to offer firms an advantage that rivals will be slow to replicate. This part explores potential drivers for strategic behavior by reviewing two categories of variables. First, this part examines the attitudinal perceptions of managers that might promote or deter strategic thinking. Second, this part 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*

The first broad category that can be explored is the attitudes of managers that populate firms. The group of attitudes that managers

¹³⁰ E.g., Leslie H. Vincent et al., *Antecedents, Consequences, and the Mediating Role of Organizational Innovation: Empirical Generalizations* 2–3 (Sing. Mgmt. Univ., Working Paper No. 9-2005, 2005), available at http://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=3904&context=lkcsb_research; see also Eric H. Kessler & Alok K. Chakrabarti, *Innovation Speed: A Conceptual Model of Context, Antecedents, and Outcomes*, 21 ACAD. MGMT. REV. 1143, 1143–44 (1996) (exploring the connection between innovation and business success).

¹³¹ See, e.g., J. Benjamin Forbes & Donald R. Domm, *Creativity and Productivity: Resolving the Conflict*, SAM ADVANCED MGMT. J., Spring 2004, at 4, 4 (“Extrinsic, financial incentives are powerful and effective motivators of personal productivity but may not be the ideal approach when creativity and innovation are required.”); Cameron M. Ford et al., *Factors Associated with Creative Strategic Decisions*, 17 CREATIVITY & INNOVATION MGMT. 171, 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 CULTURAL. MGMT. 81, 81 (2008) (studying how future managers perceive creativity barriers in order to stimulate creative behavior).

possess are known generally as attitudinal variables. Attitudinal variables are viewpoints 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 attitudinally-influenced decisions.¹³²

The attitudes of managers toward firm activities have been the subject of repeated study. Little research exists on manager attitudes toward 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.¹³³ Another explored the nature and extent of managers' perception of the electronic monitoring of employee behavior as an ethical act.¹³⁴ 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.¹³⁵

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 toward supply management impacted firm performance.¹³⁶ Others have explored attitudes toward change,¹³⁷ markets and marketing,¹³⁸ unions,¹³⁹ and destabilizing organizational pressures.¹⁴⁰

¹³² See SIEDEL & HAAPIO, *supra* note 1, at 13 ("Managers faced with myriad business concerns frequently take a reactive approach to the law. . . . [I]t is not surprising that managers often view the law as an obstacle rather than an enabler and that they tend to mentally separate the law from . . . [issues] central to competitive advantage."). David Orozco writes thoughtfully about the importance and intersection of legal knowledge and managerial knowledge in strategic behavior. See Orozco, *supra* note 66, at 687 ("Law touches virtually all aspects of management activity."). For a discussion of the overall influence of decision-makers in firm strategy, see Deborah G. Ancona & David A. Nadler, *Top Hats and Executive Tails: Designing the Senior Team*, 31 SLOAN MGMT. REV. 19, 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, 848–50 (2004); Andrew M. Pettigrew, *On Studying Managerial Elites*, 13 STRATEGIC MGMT. J. 163, 163–64 (1992).

¹³³ Robin T. Peterson & Minjoon Jun, *Small Business Manager Attitudes Relating to the Significance of Social Responsibility Issues: A Longitudinal Study*, J. APPLIED MGMT. & ENTREPRENEURSHIP, Apr. 2006, at 32, 41–42; see also Lyman E. Ostlund, *Attitudes of Managers Toward Corporate Social Responsibility*, CAL. MGMT. REV., Summer 1977, at 35.

¹³⁴ Bobby C. Vaught et al., *The Attitudes of Managers Regarding the Electronic Monitoring of Employee Behavior: Procedural and Ethical Considerations*, 18 AM. BUS. REV. 107, 110 (2000).

¹³⁵ 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, 266 (2003).

¹³⁶ 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, 473 (2003).

¹³⁷ Douglas Davis & Thomas Fisher, *Attitudes of Middle Managers to Quality-Based Organisational Change*, 12 MANAGING SERV. QUALITY 405, 405 (2002).

¹³⁸ Marie Pribova & Ronald Savitt, *Attitudes of Czech Managers Towards Markets and Marketing*, 12 INT'L MARKETING REV. 60, 60–61 (1995).

¹³⁹ Ishak Saporta & Bryan Lincoln, *Managers' and Workers' Attitudes Toward Unions in the U.S. and Canada*, 50 REL. INDUSTRIELLES 550, 550 (1995).

Still other research has explored attitudes toward managers. One study examined the varying attitudes of college students toward female managers.¹⁴¹ Another revealed that the perceived behavioral integrity of managers was positively associated with employee job satisfaction, organizational commitment, leader satisfaction, and affect toward the organization.¹⁴²

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 as 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,¹⁴³ commented in a 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."¹⁴⁴ 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."¹⁴⁵

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 compliant managers to the same obligations as those who have been negligent or dishonest.¹⁴⁶ A minority of managers viewed the new regulations, which, in part, placed responsibility on management for maintaining sound internal financial controls, "with something like gratitude."¹⁴⁷ This group

¹⁴⁰ See Anne H. Reilly et al., *The Impact of Corporate Turbulence on Managers' Attitudes*, 14 STRATEGIC MGMT. J. 167, 169 (1993) (finding that specific organizational changes have significant effects on manager's attitudes both toward their work and their employers).

¹⁴¹ Nuray Sakalli-Ugurlu & Basak Beydogan, *Turkish College Students' Attitudes Toward Women Managers: The Effects of Patriarchy, Sexism, and Gender Differences*, 136 J. PSYCHOL. 647 (2002).

¹⁴² 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, 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.

¹⁴³ *Frontline: A Dangerous Business* (PBS television broadcast Jan. 9, 2003), available at <http://www.pbs.org/wgbh/pages/frontline/shows/workplace/etc/script.html>.

¹⁴⁴ *Id.* (statement of Clyde Dorn).

¹⁴⁵ *Id.* (statement of Bart Slawson).

¹⁴⁶ Wagner & Dittmar, *supra* note 13, at 133.

¹⁴⁷ *Id.*

did not focus on literal compliance, but rather found ways to use the new law as a springboard for implementing performance-enhancing internal reforms.¹⁴⁸ For example, 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.¹⁴⁹

Intriguing questions underlie these different managerial attitudes toward the legal system. McWane and RSA Security may be illustrative of these divergent attitudes. Perhaps John Parsons, Vice President of Finance and Chief Accounting Officer of RSA Security, and his team already had an embedded attitude of respect toward the law when Parsons was responsible for implementing SOX's requirements.¹⁵⁰ This respect may have come from attitudes expressed by his CEO or fellow executives. A belief may permeate 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.¹⁵¹ Successful lobbying practices may engender in managers a sense of self-efficacy toward the law.¹⁵² 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

¹⁴⁸ *Id.* at 133–34.

¹⁴⁹ *See id.* at 137 (stating that the benefits to the firm are greater than saving costs and expenses).

¹⁵⁰ *Id.*

¹⁵¹ *See* Hillman et al., *supra* note 33, at 844–45 (discussing types of corporate political activity); Shaffer, *supra* note 33, at 503 (explaining the methods corporations use to gain political influence).

¹⁵² “Self-efficacy has been defined as the personal judgment of one's own capability to successfully perform a behavior.” Lynne L. 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, 453 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”) (quoting ALBERT BANDURA, *SOCIAL FOUNDATIONS OF THOUGHT AND ACTION: A SOCIAL COGNITIVE THEORY* 391 (1986)).

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 the legal process may also influence the propensity toward strategy. A manager may have a negative experience with litigation or arbitration, either as a defendant or as a non-party participant.¹⁵³ A manager may also suffer the scrutiny of overzealous enforcement. For example, in securities regulation, United States regulators apparently compete to be what one author calls the “toughest cop on the street,” while regulation of markets in the United Kingdom tends to be more collaborative and solution oriented.¹⁵⁴ 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 manager has not experienced successful collaboration with regulators it is unlikely that the manager will consider collaboration with regulators as an opportunity.¹⁵⁵

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.¹⁵⁶ Managers may dismiss a lawyer’s counsel assuming that lawyers create problems so that they can justify their own existence.¹⁵⁷ 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

¹⁵³ See Russel Myles & Kelly Reese, *Arbitration: Avoiding the Runaway Jury*, 23 AM. J. TRIAL ADVOC. 129, 133 (1999) (describing the “runaway jury” as an “expense that cannot be predicted or accounted for with any real accuracy or reliability” and a factor contributing to the unattractiveness of litigation).

¹⁵⁴ 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).

¹⁵⁵ See Richard W. Painter, *Game Theoretic and Contractarian Paradigms in the Uneasy Relationship Between Regulators and Regulatory Lawyers*, 65 FORDHAM L. REV. 149, 153, 178–79 (1996) (examining relationships between regulators, regulated firms, and lawyers from the vantage point of game theory and Coasian contractual theory).

¹⁵⁶ Bird, *supra* note 36, at 13.

¹⁵⁷ *Id.*

firm's objectives regardless of their wisdom or legality.¹⁵⁸ Added to the difficulty lawyers face is that they are often the bearers of bad news. As Elihu Root reportedly observed, "half the practice of a decent lawyer consists in telling would-be clients that they are damned fools and should stop."¹⁵⁹ 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 toward lawyers.¹⁶⁰ "Authoritative," "insensitive," "arrogant," and "intimidating" were words used by these owners to describe attorneys.¹⁶¹ Respondents complained that attorneys refused to admit mistakes and failed to know answers to client questions.¹⁶² Attorneys measured their productivity by how many documents they produced, and not by whether problems were solved quickly and cheaply.¹⁶³ One participant reported that a law firm hired for a routine acquisition refused to rely on documents already vetted by other lawyers, and the transaction resulted in a \$27,000 legal bill.¹⁶⁴

Just as plant managers have been surveyed to study the impact of management practices on competitive advantage,¹⁶⁵ 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 ninety-six percent of general counsel worked on "regulatory compliance" matters, only sixty-two percent served in a "strategic development" capacity.¹⁶⁶ Similarly, while sixty-nine percent of the surveyed CEOs reported that the

¹⁵⁸ Fred C. Zacharias, *Effects of Reputation on the Legal Profession*, 65 WASH. & LEE L. REV. 173, 190-91 (2008).

¹⁵⁹ *Id.* at 190 n.53 (citing 1 PHILLIP C. JESSUP, ELIHU ROOT 133 (1938)).

¹⁶⁰ 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 toward 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*, QUALITY PROGRESS, 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 or seven levels."); Rachelle Cortis & Vincent Cassar, *Perceptions of and About Women as Managers: Investigating Job Involvement, Self-Esteem and Attitudes*, 20 WOMEN MGMT. REV. 149, 153 (2005) (applying a four-point Likert scale ranging from "strongly agree" to "strongly disagree" to gauge job involvement among managers).

¹⁶¹ Geyelin, *supra* note 160, at B1.

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ See, e.g., Flynn et al., *supra* note 27, at 659, 668.

¹⁶⁶ HEIDRICK & STRUGGLES INT'L, INC. & THE MINORITY CORP. COUNSEL ASS'N, THE FORTUNE 500 CEO SURVEY ON GENERAL COUNSEL 2 (2000). The question asked to respondents was: "What are the strategic issues that General Counsel work on?" *Id.*

most important role of general counsel was to “find solutions to legal problems,” only thirty-one percent stated that it was to “develop advantages in the legal and regulatory framework” of the industry.¹⁶⁷ This survey also revealed that only four percent of CEOs surveyed believed that strategic thinking would be a skill set sought in a new general counsel.¹⁶⁸ By contrast, other nationwide interviews of CEOs and general counsel have revealed no predictable attitude toward lawyers from CEOs who had themselves practiced law.¹⁶⁹

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 1000 companies in order to better understand their role as legal advisor.¹⁷⁰ The authors concluded that corporate counsel generally performed one of three roles: a cop role, a counsel role, or an entrepreneur role.¹⁷¹ Attorneys playing the cop role mostly performed legal gate-keeping functions such as imposing compliance programs, approving contracts, and responding to legal questions.¹⁷² Cop-attorneys emphasized the importance of independent judgment and saying “no” when a proposed action was illegal.¹⁷³ Counsel-attorneys, by contrast, also performed gate-keeping roles but expanded their relationship into one that makes suggestions based on business, ethical, and situational concerns.¹⁷⁴

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.”¹⁷⁵ The authors concluded that these counsel derive meaning from furthering the business conception of the corporation, a profit-making and capitalist institution.¹⁷⁶ When interviewed, in-house counsel of this type expressed enthusiasm for making deals, raising money, and acquiring other companies.¹⁷⁷ They

¹⁶⁷ *Id.* at 5.

¹⁶⁸ *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.*

¹⁶⁹ Larry Smith, *Lawyer-CEOs: No Predictable Attitudes Concerning Legal Function*, 11 OF COUNSEL 28, 28 (1992).

¹⁷⁰ 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, 460–61 (2000).

¹⁷¹ *Id.* at 462.

¹⁷² *Id.* at 463.

¹⁷³ *Id.* at 463–64.

¹⁷⁴ *Id.* at 464.

¹⁷⁵ *Id.* at 466.

¹⁷⁶ *Id.* at 468.

¹⁷⁷ *Id.* at 466.

offered advice beyond the legal function not only because they felt comfortable doing so, but also because they were expected to do so by fellow executives.¹⁷⁸ Business achievements rather than legal objectives may primarily motivate such counsel.¹⁷⁹

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.¹⁸⁰ 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 toward business decisions, the ability to exercise judgment, and an attitude of responsibility.¹⁸¹

Finally, legally strategic behavior might be influenced by managers' attitudes toward risk. Scholars have explored managers' attitudes toward risk using a variety of criteria.¹⁸² 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.¹⁸³ 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.¹⁸⁴ One study found that the passage of disability laws

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 468.

¹⁸⁰ *Id.*

¹⁸¹ See Bagley, *supra* note 55, at 379–83 (describing the components of legal astuteness).

¹⁸² See, e.g., Abbas J. Ali, *Decision-Making Style, Individualism, and Attitudes Toward Risk of Arab Executives*, INT'L STUD. MGMT. & ORG., Fall 1993, at 53, 62 (measuring attitude toward risk through questions regarding "creativity, intuition, information needed in making decisions, and the steps and procedures in decision making"); Audrey Gilmore et al., *Small Business Owner-Managers and Their Attitude to Risk*, 22 MARKETING INTELLIGENCE & PLAN. 349, 350–51 (2004) (discussing the trait approach and cognitive approach to understanding risk).

¹⁸³ Cf. King, *supra* note 102, 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.") (citation omitted).

¹⁸⁴ See 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

protecting employees triggered a decrease in fixed asset spending by firms apparently taking a wait-and-see approach to the new law.¹⁸⁵ Although disability law can influence fixed asset spending due to changes in physical plants to accommodate disabled workers, the approximately eleven percent drop in spending (\$1878 per employee) was out of proportion to other studies' estimated costs of disability accommodations (average cost of an accommodation, \$121.42).¹⁸⁶ Similarly, another study found that managers reacted to the adoption of wrongful discharge laws¹⁸⁷ as if the cost of exposure were one hundred times as great as the actual legal costs.¹⁸⁸ 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.¹⁸⁹

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

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 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.") (discussing ROBERT K. MERTON, *SOCIAL THEORY AND SOCIAL STRUCTURE: TOWARD THE CODIFICATION OF THEORY AND RESEARCH* 200 (1957)).

¹⁸⁵ Robert C. Bird & John D. Knopf, *Do Disability Laws Impair Firm Performance?*, 47 *AM. BUS. L.J.* 145, 179–81 (2010). 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 as "land, vehicles, buildings, office equipment, furniture, computers, and machinery." *Id.* at 177.

¹⁸⁶ *Id.* at 179–80 (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 18, http://bbi.syr.edu/publications/blank_docs/1995-1999/annen_follow_up_96_sears.pdf). Other studies predict varying costs. One reports that only one percent of accommodations cost between \$500 and \$1000 while another concluded that the average cost of accommodation was \$930. Bird & Knopf, *supra* note 185, at 180.

¹⁸⁷ 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. Robert C. Bird, *Rethinking Wrongful Discharge: A Continuum Approach*, 73 *U. CIN. L. REV.* 517, 521–22, 526–27 (2004).

¹⁸⁸ JAMES N. DERTOUZOS & LYNN A. KAROLY, *RAND, 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 the findings of the RAND study conducted by Dertouzos and Karoly).

¹⁸⁹ DERTOUZOS & KAROLY, *supra* note 188, at 36–37; see also Lauren B. Edelman et al., *Professional Construction of Law: The Inflated Threat of Wrongful Discharge*, 26 *LAW & SOC'Y REV.* 47, 74 (1992) (exploring possible explanations for the striking disparity between the actual threat and the perceived threat posed by wrongful discharge lawsuits).

decision-making ability and overall competence.¹⁹⁰ Risk tolerance may thus be associated with a propensity toward 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 sources of legal strategy.

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

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.¹⁹¹ 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,¹⁹² strategic change,¹⁹³ creativity,¹⁹⁴ firm performance,¹⁹⁵ and internationalization.¹⁹⁶ Attributes of organizations such as size of teams,¹⁹⁷ size of the firm,¹⁹⁸ innovative activity,¹⁹⁹ and

¹⁹⁰ DERTOUZOS & KAROLY, *supra* note 188, at 37.

¹⁹¹ 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, 1 (2005) (listing performance measure, criterion, and metric as synonyms for "attribute"). 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.

¹⁹² See Rajeswararao Chaganti & Rakesh Sambharya, *Strategic Orientation and Characteristics of Upper Management*, 8 STRATEGIC MGMT. J. 393, 393 (1987) (examining external recruitment of managers and their functional background).

¹⁹³ See Warren Boeker, *Strategic Change: The Influence of Managerial Characteristics and Organizational Growth*, 40 ACAD. MGMT. J. 152, 158 (1997) (exploring tenure of managers and heterogeneity).

¹⁹⁴ See Karen A. Bantel & Susan E. Jackson, *Top Management and Innovations in Banking: Does the Composition of the Top Team Make a Difference?*, 10 STRATEGIC MGMT. J. 107, 109–12 (1989) (examining age, tenure, education level, firm size, and firm location).

¹⁹⁵ See Alan I. Murray, *Top Management Group Heterogeneity and Firm Performance*, 10 STRATEGIC MGMT. J. (SPECIAL ISSUE) 125, 129 (1989) (examining heterogeneity of managers by reviewing age, tenure, occupational diversity, and educational diversity).

¹⁹⁶ See Caligiuri et al., *supra* note 132, at 849–50 (discussing how the attributes of a firm's top managers affect the firm's level of internationalization).

¹⁹⁷ 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*, S. ASIAN J. MGMT., Oct.–Dec. 2007, at 96, 98.

¹⁹⁸ Nermin Ozgulbas et al., *Identifying the Effect of Firm Size on Financial Performance of SMEs*, BUS. REV., CAMBRIDGE, Dec. 2006, at 162, 167.

¹⁹⁹ Weijun He & Ming Nie, *The Impact of Innovation and Competitive Intensity on Positional Advantage and Firm Performance*, J. AM. ACAD. BUS., Sept. 2008, at 205, 205.

workplace flexibility²⁰⁰ have all been studied for their impact on firm performance. Just as attributes can impact a variety of firm measures, it is likely that they can influence whether a firm pursues a legal strategy as well.

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 themselves to be dynamic and persistent leaders. As of December, 2004, fifty-four 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.²⁰¹ 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 and failed, but lawyer-CEOs may help firms better recognize and address controversial issues such as corporate governance, ethics, and social responsibility.²⁰²

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 allows 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 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

²⁰⁰ Angel Martínez Sánchez et al., *Teleworking and Workplace Flexibility: A Study of Impact on Firm Performance*, 36 PERSONNEL REV. 42, 43 (2007).

²⁰¹ See Mike France & Louis Lavelle, *A Compelling Case for Lawyer-CEOs*, BUS. WK., Dec. 13, 2004, at 88, available at http://www.businessweek.com/magazine/content/04_50/b3912101_mz056.htm ("10.8% of the CEOs of companies in the Standard & Poor's 500-stock index have law degrees.").

²⁰² *Id.* at 90.

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 CEOs do not view their general counsel as reservoirs of strategy,²⁰³ 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. Pratt & Whitney, for example, is a division of United Technologies Corporation that designs, manufactures and services aircraft engines, industrial gas turbines and space propulsion systems.²⁰⁴ 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.²⁰⁵ Only half of the employees in the department are attorneys.²⁰⁶ 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

²⁰³ HEIDRICK & STRUGGLES INT'L, INC. & THE MINORITY CORP. COUNSEL ASS'N, *supra* note 166, at 2-3, 5.

²⁰⁴ *Pratt & Whitney: An Overview*, PRATT & WHITNEY, http://www.pw.utc.com/about_us/an_overview.asp (last visited June 29, 2011).

²⁰⁵ Greg Fearn, *International Trade Compliance at Pratt & Whitney* (2008) (PowerPoint presentation) (on file with author). Greg Fearn is a manager of export/import compliance in Pratt & Whitney's Legal Department. *Id.*

²⁰⁶ *Id.*

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.²⁰⁷ 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.²⁰⁸ A corporate code is a statement of values developed by an organization which employees should follow or aspire.²⁰⁹ Credos can not only require employees to follow the law but commit themselves to principled business conduct, high ethical standards, and respect for stakeholders.²¹⁰ For example, Johnson & 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.²¹¹

²⁰⁷ France & Lavelle, *supra* note 201, at 88; see also Richard S. Gruner, *General Counsel in an Era of Compliance Programs and Corporate Self-Policing*, 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."); J. K. Himmelreich, *A Compliance Office for Heavily Regulated Enterprises—A Best Practice Approach To Meeting US FDA Requirements*, BT TECH. J., July 2007, at 41, 41 (discussing how pharmaceutical firm compliance offices can implement best practices toward regulations, contractual requirements, and other policies and procedures).

²⁰⁸ 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 et al., *Corporate Ethics Practices in the Mid-1990's: An Empirical Study of the Fortune 1000*, 18 J. BUS. ETHICS 283, 283 (1999).

²⁰⁹ See, e.g., Margaret Anne Cleek & Sherry Lynn Leonard, *Can Corporate Codes of Ethics Influence Behavior?*, 17 J. BUS. ETHICS 619, 622 (1998) ("A code of ethics is a formal document that states an organization's primary values and the ethical rules it expects its employees to follow."); M. Schwartz, *The Nature of the Relationship Between Corporate Codes of Ethics and Behaviour*, 32 J. BUS. ETHICS 247, 248 (2001) ("[A] code of ethics is considered to be a written, distinct, and formal document which consists of moral standards to be used to guide employee or corporate behavior.").

²¹⁰ Bird, *supra* note 112, at 170–72 (describing nature and function of various corporate codes).

²¹¹ See, e.g., David Collins, *A Lesson in Social Responsibility: Corporate Response to the 1980's Tylenol Tragedies*, 27 VT. L. REV. 825, 825–26 (2003) (describing Johnson & Johnson's response to

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.²¹² 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.²¹³ 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.²¹⁴ 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 company.

the tampering). David Collins was a member of the strategy committee that managed the Tylenol crisis. *Id.* at 825.

²¹² Some studies, though by no means all, find that evidence of corporate values are positively correlated with firm performance. E.g., Han Donker et al., *Corporate Values, Codes of Ethics, and Firm Performance: A Look at the Canadian Context*, 82 J. BUS. ETHICS 527, 536 (2008).

²¹³ Bird, *supra* note 112, at 177–78.

²¹⁴ See Craig C. Albert, *The Lawyer-Director: An Oxymoron?*, 9 GEO. J. LEGAL ETHICS 413, 416–17 (1996) (explaining the argument that clients receive better legal advice when outside counsel serves the clients’ board of directors); Patrick W. Straub, Note, *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, 263–64 (2000) (describing the benefits of having a lawyer-director with a unique legal perspective on a firm’s board of directors).

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.

IV. CONCLUSION

Law can be a source of sustainable competitive advantage as it potentially satisfies 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 toward 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,²¹⁵ 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

²¹⁵ HEIDRICK & STRUGGLES INT'L, INC. & THE MINORITY CORP. COUNSEL ASS'N, *supra* note 166, at 2.

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.²¹⁶

Law is the information technology of the twenty-first century—a veritable “black box” of untapped competitive advantage.²¹⁷ 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.

²¹⁶ Downes, *supra* note 10, at 19.

²¹⁷ *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