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Seizing Competitive Advantage

A Legal Plan for Managers

Congratulations! Last year the chief executive officer of your company named you general manager of one of the firm's most important divisions. Your first year as head of the division has been a success, as you have exceeded the goals set by corporate headquarters.

Condolences! You have no time to savor your early success. You and the CEO recently analyzed business trends. You both anticipate that the market for your products will become much more competitive, especially with a recent increase in foreign competition. The CEO emphasizes that your division must gain competitive advantage over rival companies in order to survive.

Beyond concerns about the survival of your division, you have other worries. If you fail as leader of the division, it will be difficult to return to a lower-level position—and in the current economic climate you may be unable to find a general manager position at another company. You also feel responsible for the division's employees. The division is the largest employer in your town, and a shutdown would devastate the local economy, as well as the families of your employees.

As you plan for the coming year, you develop a list of your goals. High on your list are attracting, developing, and retaining the best employees, thinking and planning more strategically about the future, maintaining a high-performance climate in your division, and improving the satisfaction of your customers. To this list you add a personal goal—managing time and stress—because your work increasingly pulls you away from your family and you have little time for recreation.

You then list three key legal obstacles that might prevent you from achieving your goals (while also increasing your stress levels). These problems are increased workers' compensation costs, high product liability insurance premiums, and major costs incurred in complying with environmental regulations.

Beyond these general concerns, you are worried about a lawsuit that might have a significant impact on the company and on you personally. A year ago, when you took over leadership of the division, you fired an employee who was not performing to your expectations. The employee has now sued you and the company, claiming breach of contract. The employee also claims that you defamed him by making untrue statements about his performance. As a result of this lawsuit, you are reluctant to terminate other poor performers, for fear that they might also file suit. Therefore, you write down a fourth problem—the wrongful termination lawsuit. Your goals and obstacles are listed in Exhibit 1.1.

Exhibit 1.1. Your Planning List.

Goals
1. Attract, develop, retain best employees.
2. Think and plan strategically about future.
3. Maintain a high performance climate.
4. Improve customer satisfaction.
5. Manage time and stress.
Problems
1. Increased workers' compensation costs.
2. Product liability insurance premiums.
3. Compliance with environmental regulations.
4. Wrongful termination lawsuit.

If it is any consolation—and misery does indeed love company—you have lots of company among managers at firms around the world. Achieving competitive advantage is critical to the success and even the survival of companies that cross a variety of industries and cultures. Managers at these companies share the goals listed in Exhibit 1.1. In a study based on over seventeen hundred responses from entry-level, middle, and senior managers, researchers at the University of Michigan Business School concluded that the goals on this list match the leading challenges faced by managers worldwide.[1]

The legal problems on your list, such as environmental and workers' compensation costs, also rank among the top business concerns.[2] Legal issues in general have emerged as the most important factor in the external environment in which business operates. It is estimated that Fortune 500 executives spend 20 percent of their time on litigation-related matters.[3] It is no wonder that business executives attending management development programs rank law among the three most important business topics, along with human resources and finance.[4]

John Seeley Brown, director of Xerox Research Center, once observed that "Managers don't make products; they make sense."[5]

In your leadership role, as you attempt to make sense of the legal challenges in your competitive environment, it is easy to become mesmerized by the complexity of the law, like a deer in the lights of oncoming highway traffic. In a sense, the goal of this book is to provide a plan—the Manager's Legal Plan—that will enable you to cross the legal highways that intersect your business strategies while minimizing the risk of being struck down by legal liability. In a broader sense, however, the goal is to help you recognize that the so-called legal problems on your list are in reality opportunities for competitive advantage.

This chapter will introduce the Manager's Legal Plan by first explaining the business concept of competitive advantage. The chapter will next describe the traditional approach used by managers when confronted with legal problems. The traditional approach will then be contrasted with a different approach that enables you to use the law to achieve competitive advantage. The chapter will close with a brief overview of the remaining chapters in the book.

■ The Essence of Competitive Advantage

The concept of competitive advantage is central to business success around the world. Because this concept is subject to differing interpretations, it is useful at the outset to provide a working definition as a point of reference for the chapters that follow.

The definition of competitive advantage is straightforward: Your goal in business is to gain an *advantage* over your *competitors.* If you were a college basketball coach, you would try to gain advantage over competitors by recruiting athletes who are taller and faster than players on opposing teams. You would attempt to develop game plans that maximize your strengths and exploit your opponents' weaknesses. You would develop a train-

ing program and organize practices to improve the performance of your athletes. In other words, your goals as a coach would be similar to the business goals in Exhibit 1.1.

Of course, college basketball teams and businesses use different measures of success. In college basketball, the success of a coach is determined primarily by whether fans are satisfied with the number of games that the team wins during the season. In business, a manager must also satisfy the fans (customers) but must do so in a manner that produces profits for the firm's owners.

As a result, a company seeking competitive advantage must satisfy two requirements. First, the company must create value for its customers that is superior to the value offered by its competitors. Superior value, as Harvard professor Michael Porter explains in his book *Competitive Advantage*, "stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price."[6] Second, the amount that buyers are willing to pay for this value must exceed the company's costs if the firm is to be profitable. As Porter puts it, "Competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it."[7]

As we will see in the chapters that follow, law plays an important role in both reducing costs and creating value for your customers—by enabling you to offer either lower prices or products that provide unique benefits. If all companies took full advantage of their legal resources, any resulting advantage over the competition would disappear. However, because law is an untapped source of competitive advantage that will continue to be misunderstood by many managers, selected companies should be able to leverage their legal resources into a source of competitive advantage that is sustainable over the long term.

The Conventional Approach to Legal Problems

The approach most managers use when dealing with legal matters contains many pitfalls. Managers often start with a mindset that separates legal issues from the strategic and operational concerns of the business. As Exhibit 1.1 implies, too often, legal concerns are treated as problems to be resolved as quickly as possible so that attention can be focused on business goals. This attitude overlooks the fundamental point that, even if legal matters are viewed as problems, they affect the business goals of both you and your competitors. The companies that can best resolve these problems—and the managers who develop bridges between the lists in Exhibit 1.1—create an opportunity to seize competitive advantage. In other words, successful managers ask the question: How can this legal problem create an opportunity to gain an advantage over our competitors?

Given the current approach that too often separates legal and business concerns, managers typically engage in a two-step process when addressing legal concerns. The first step is to meet with an attorney to discuss their rights and obligations. For instance, in responding to the wrongful termination case filed by your former employee, you would first meet with your attorney to determine whether the claim has any merit. During the course of your conversation, the attorney would explain the breach of contract and defamation claims, and would also discuss whether it is likely that the employee would win in court, the potential damages, and the costs of the litigation.

Following the briefing by an attorney, the second step is to activate the flight-or-fight responses that have developed in humans over millions of years and allow us to survive in dangerous situations. In a legal sense, there are two flight options for your company (see Figure 1.1). First, flight might involve settlement of a specific case, such as your wrongful termination law-

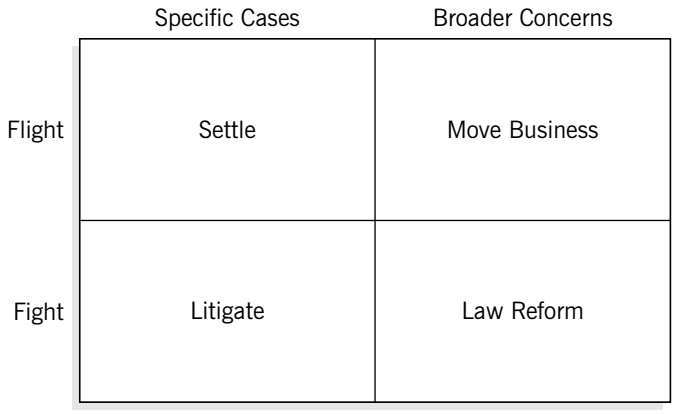


Figure 1.1. **Conventional Approaches to Legal Problems.**

suit. Second, if certain types of cases are so common that they prevent your company from achieving competitive advantage, then flight might involve movement of the business to another state or country. Examples include situations where your state workers' compensation costs might cause you to move your factory to another state, or federal environmental burdens might cause you to move operations to another country.

The fight response also includes two options. One option is to fight individual claims in court on a case-by-case basis. The other option is to take the fight to a higher level and fight to reform laws that have a detrimental impact on business. For instance, in addition to fighting individual workers' compensation cases, your company might push for legal reform that would reduce the financial burden of workers' compensation.

For reasons stated in the sections that follow, the traditional flight-or-fight responses have become more difficult—or in some situations impossible—to execute successfully. Thus, in a global economy, the manager's conventional approach to legal concerns is often no longer realistic.

Difficulties with the Flight Response

Both of the characteristic flight responses can lead to problems in the current environment. Sometimes, neither settlement of a specific case nor movement of your business makes sense.

The Strategy of Settling Specific Cases

Flight from litigation through settlement of a specific case often appears to be a logical course of action—even when it is likely that your company will win if the case goes to trial. If you can settle a case for $50,000 and it will cost you $100,000 to litigate the case even if you win, common sense tells you to settle.

However, the total cost of settlement might be much higher than litigation costs when, by settling the case, you signal to plaintiffs and their attorneys that you are willing to pay to settle future cases to avoid a trial even when you have a winning case. Professor John Coffee of Columbia Law School, in commenting on a 2001 Merrill Lynch settlement with a client who lost money on a stock market investment, put it this way: "[Settlement] is like putting out warm milk for a stray cat that meows. You get 30 more cats the next night. This will create an incentive for others" to sue.[8] Settlements also result in additional costs that far exceed the amount of the payments. For instance, as discussed in Chapter Three, the costs of workers' compensation—including lost productivity and expenses incurred in training replacements—far exceed amounts paid in settlements with workers.

Flight through settlement can also be problematic when there are two defendants. A settlement offer made by a plaintiff to the two defendants—for instance, in a lawsuit filed by a consumer against your company and another company—can create a problem called the prisoner's dilemma. For example, two hypothetical prisoners, Bonnie and Clyde, have been charged with bank robbery and assault. A police detective interrogates them

in separate rooms. Bonnie and Clyde know that even if they don't confess to the charges, the police have enough evidence to convict them for assault, which carries a prison term of three years. The police tell them that if only one of them confesses, that person will receive a prison term of one year and the other will receive an eight-year term. If both confess, the prison term for both charges would be four years each. The police do not allow Bonnie and Clyde to communicate with each other. If you were Bonnie, would you confess?

As Figure 1.2 illustrates, it appears that the most rational strategy is for Bonnie (and Clyde) to confess. That is, no matter what choice Clyde makes (confess or do not confess), Bonnie's best strategy is to confess. The dilemma for these prisoners is that, although it is rational for each of them as an individual to confess, collectively they end up in a worse position (four-year prison terms) than if they had both refused to confess (in which case they would receive three-year terms).[9]

If, instead of prisoners, Bonnie and Clyde are two small competing companies (Bonnie, Inc. and Clyde, Inc.) that make components for a toy, a similar dilemma may arise. For instance,

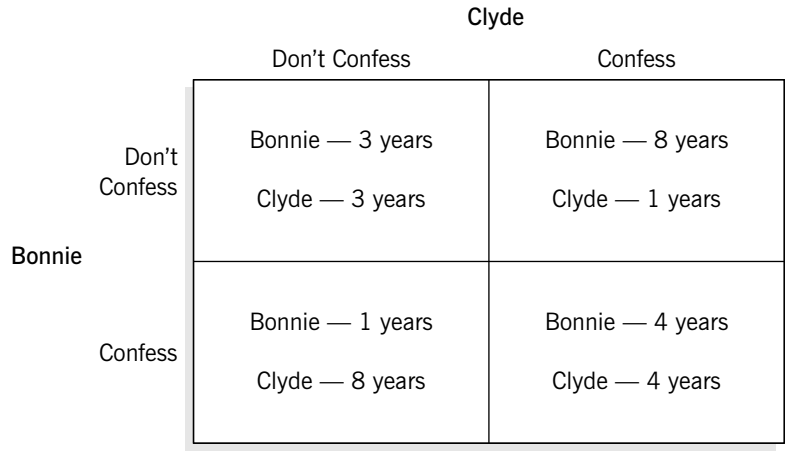


Figure 1.2. Prisoner's Dilemma.

a child sustains minor injuries while using the toy and an attorney files a $300,000 lawsuit against both companies. The case has little merit and the attorney hopes to extract a settlement from the companies rather than going to trial. The two companies have filed claims against each other, arguing that if there is any liability, it should fall on the other company.

If both companies refuse to settle, they will each incur litigation costs of $30,000 in asking for a dismissal of the case (which they are certain a court would grant). The plaintiff's attorney offers each company the opportunity to settle immediately, promising to accept a settlement of $10,000 from one defendant if that defendant agrees to help in the case against the remaining defendant. (In one version of this type of settlement, named a "Mary Carter" agreement after a case involving the Mary Carter Paint Company,[10] the plaintiff settles with one defendant for a certain amount. This amount is then reduced depending on how much the other defendant eventually has to pay the plaintiff.) Given the settling defendant's assistance to the plaintiff, the other defendant would be unable to obtain an early dismissal, but would still probably win at trial—at a cost of $80,000 in legal expenses. The plaintiff's attorney is willing to settle immediately with both companies for $40,000 each.

If you manage Bonnie, Inc., it appears that your most rational strategy—similar to the decision made by prisoner Bonnie—is to settle (as illustrated in Figure 1.3). But you face the same dilemma as the prisoners in that, although it is rational for each company to settle, they are both in a worse position (each settling for $40,000) than if they had refused to settle (in which case their costs would have been $30,000 each). But because they are competitors and adversaries in the litigation, they are unlikely to cooperate. Even if they did reach a tentative agreement, each company is afraid that the other might back out at the last minute or might enter into a secret Mary Carter agreement.

Bonnie, Inc. \ Clyde, Inc.	Litigate	Settle
Litigate	Bonnie, Inc. — $30,000 Clyde, Inc. — $30,000	Bonnie, Inc. — $80,000 Clyde, Inc. — $10,000
Settle	Bonnie, Inc. — $10,000 Clyde, Inc. — $80,000	Bonnie, Inc. — $40,000 Clyde, Inc. — $40,000

Figure 1.3. Company Settlement Dilemma.

Thus flight from litigation through settlement is problematic. There is a risk that single-party decisions to settle based on a simple cost-benefit analysis (it may be cheaper to settle than to litigate a winning case) and decisions in the two-party prisoner's dilemma scenario fuel litigation by encouraging attorneys to file lawsuits even when their chance of success at trial is slight.

The Strategy of Moving the Company

When certain types of liability, such as workers' compensation payments or environmental costs, become burdensome, it is tempting to consider the flight option of moving your business to another state or country. Under traditional notions of *comparative* advantage, certain countries have a comparative advantage over others as a result of cost advantages, including legal costs. But in a global economy, countries face difficulty in achieving comparative legal advantage for two reasons illustrated by Figure 1.4: the cross-border movement of goods, services, and investments, and the increasing convergence of legal rules and regulations.

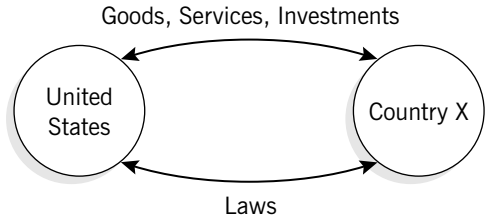


Figure 1.4. Decline of Comparative Advantage.

Cross-Border Movement of Goods, Services, and Investments. The movement of goods, services, and investments across political borders means that you will be subject to regulation and liability in other countries regardless of where the goods and services are produced. For example, if you are operating a plant in Country X (see Figure 1.4), you are subject to liability for injuries caused by your goods in the United States.

The rationale for this liability was explained in a 1988 Nevada case involving the band Judas Priest. One evening two young men went to an empty churchyard and attempted to commit suicide. The first man succeeded, after propping a sawed-off shotgun under his chin and pulling the trigger. The second man somehow survived a similar suicide attempt, but suffered severe injuries. The survivor and the mother of the decedent filed a lawsuit in Nevada against the members of Judas Priest, who were residents of Great Britain. The plaintiffs claimed that the suicidal actions were caused by one of the band's albums, called "Stained Class."

Before deciding whether the band was liable, the Nevada court first had to determine whether it had the right to hear a case involving residents of another country. The court determined that the courts of Nevada could hear cases like this because "the band members consciously and deliberately chose to develop a world-wide market."[11]

In today's global economy, especially as electronic commerce facilitates global product reach, companies increasingly

choose "to develop a world-wide market." As a result, they must be prepared to defend lawsuits in other countries, even those that they eventually win—as did the members of Judas Priest. In other words, in a world where the mantra "think globally, act locally" applies to law as well as to other aspects of business, the traditional option of flight to a country with minimal legal requirements has been considerably diluted.

Convergence of Legal Rules. Laws increasingly move across political borders, resulting in convergence of the legal rules that govern business practice. In many cases, this convergence takes place through the spread of U.S. rules and regulations to other countries. An article in the *Economist* on a new California law begins by describing this familiar legal migration pattern: "California today, America tomorrow—and the rest of the world the day after."[12] However, Figure 1.4 illustrates that law reform moves in two directions, as laws in other countries also influence legal developments in the United States.

Law can be divided into two broad categories—substantive and procedural—both of which have been affected by convergence in recent years. *Substantive law* deals with the substance of the law—the legal rules and regulations that govern business operations and management decision making. *Procedural law* is the body of law relating to the enforcement of substantive law.

The following examples illustrate the convergence of substantive law.

- *Contract law.* A relatively new international law, the United Nations Convention on Contracts for the International Sale of Goods, establishes a uniform set of rules for contracts involving buyers and sellers from different countries. Originally ratified by the United States and ten other countries in 1988, these rules now have been adopted by close to sixty countries. By reducing legal differences from one country to

another, the Convention lowers contract law barriers to international trade.

- *Product liability.* Product liability, your company's liability for defective products, will be discussed in Chapter Two. As noted in that chapter, U.S.-style product liability has spread to the European Union and to the Pacific Rim, including Australia, China, the Philippines, and Japan. Describing product liability laws in Europe in an article titled "Sue Everywhere," *Forbes* magazine notes that "savvy companies are starting to realize they face a whole new continent of potential plaintiffs."[13]
- *Environmental law.* Here, too, U.S.-style liability has spread throughout the world. As the head of environmental affairs for a multinational company confided to me, based on his analysis of environmental regulations in countries around the world, "it seems as though other countries have adopted carbon copies of American law." Environmental regulation will be explored further in Chapter Four.
- *Securities regulation.* Countries around the world have come to realize that fair and consistent regulation is necessary if investors are to have faith in the securities market. For example, many countries in recent years have adopted insider-trading laws that are similar to U.S. law.
- *Sexual harassment.* Laws that originated in the United States relating to sexual harassment have now become the international standard. Sexual harassment will be covered in Chapter Three.
- *Anti-bribery law.* The United States led the fight against bribery with the adoption of the Foreign Corrupt Practices Act in 1977. Because other leading industrial countries did not have similar laws, U.S. companies claimed that foreign firms had an unfair advantage. For instance, it is estimated that in one year alone, bribes for competitors caused U.S. companies to lose over $15 billion.[14] But in 1997, over two

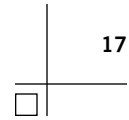
dozen countries signed an anti-bribery agreement that has leveled the playing field for U.S. companies.

Even U.S.-style law that has not officially been adopted by other countries often has an extraterritorial reach. For example, U.S. employees working for U.S. firms are protected by U.S. employment laws when working in other countries. Other laws, such as antitrust law, apply to non-Americans acting outside the United States when their conduct has an impact on the United States. And U.S. law is frequently embedded in codes of conduct adopted by multinational companies. In total, according to international lawyer Gregory J. Wallance, "The cold war paradigm was the United States as global policeman. The post-cold-war paradigm is the United States as global attorney."[15]

Procedural law, as noted earlier, deals with the enforcement of substantive law. Historically, six features of the legal process distinguished the United States from the rest of the world. In recent years convergence has had an impact on these features in two ways. First, the impact of some features (see the first three items on the following list) has been diminished by law reform in the United States. Second, other features (the second half of the list) are being exported to other countries.

- *Jury trials.* Unlike most countries in the world, the United States still allows litigants the option of a jury trial in civil lawsuits. However, the right to jury trial has diminished recently as a result of a combination of factors, including an increase in the use of arbitration, laws in most states that limit the amount of damages that juries can award, requirements that judges hear certain types of cases, and dismissal of cases by judges before they reach a jury. In the words of Ron Cohen, the chair of the American Bar Association Litigation Section: "For the first time in our country's history, the future of the jury system is in serious jeopardy."[16]

- *Punitive damages.* The United States is unusual in allowing plaintiffs to recover punitive damages when defendants have engaged in egregious behavior. Over the past several years, however, many states have enacted legislation limiting punitive damages.
- *Legal expenses.* Unlike other countries, which typically use a "loser pays" approach, in the United States the winning party must pay most of its own legal costs. This traditional American rule is being eroded as new legislation in the United States frequently provides that the loser must pay the winner's full legal costs.
- *Contingency fees.* In the United States, contingency fee agreements—where the payment to a lawyer is contingent on the outcome of the case—are legal. For example, if you agree to pay your attorney a 30 percent contingency fee and the jury awards you $10 million, the lawyer's fee is $3 million. If the jury decides that you are not entitled to damages, the attorney receives 30 percent of 0. Other countries have joined the United States in allowing contingency fees, including Canada, the United Kingdom, Japan, and China.
- *Discovery.* Discovery is the process used by attorneys to locate evidence and witnesses for use at trial. For instance, the opposing lawyer has the right to search through your business records for evidence that might be relevant to the case. E-mail has been an especially fruitful source of evidence. In one case, after Atlantic Richfield (ARCO) sold its solar energy subsidiary to Siemens, ARCO employee e-mail messages such as the following were discovered: "We will attempt to finesse past Siemens the fact that we have had a great amount of trouble in successfully transitioning technology from the laboratory to the manufacturing floor." These e-mail messages contributed to a Siemens lawsuit requesting $146 million in damages.[17] In recent years, other countries have moved closer to U.S.-style discovery. In



Japan, for example, rules adopted in 1998 make it easier to obtain evidence from the opposing side.

- *Class actions.* If your company illegally overcharges me $10 for your product, it is unlikely that I will bother filing suit for this small amount of damages. But if the company overcharges a million customers, a lawsuit filed on behalf of these customers—called a class action—converts a $10 claim to a $10 million lawsuit (or possibly $30 million if damages are trebled, as they might be in this type of case). Critics of class actions claim that the real winners in class actions are attorneys, whose 30 percent contingency fee would net them millions of dollars. Their clients, on the other hand, would receive the price of lunch (70 percent of $10, or of $30 as a best case) *before* expenses were taken out of their share. Despite their controversial nature, class actions are now allowed in a number of other countries, including Australia, Canada, the United Kingdom, China, and Japan.

We have examined several examples of the convergence of substantive and procedural law. It is said that a butterfly flapping its wings in the United States can cause a typhoon in Asia. Similar to this "butterfly effect," convergence of the law causes a legal development in one country to change business practice elsewhere. Several years ago, for instance, McDonald's was sued in the United States in a controversial case involving an elderly woman who was burned when she spilled her cup of McDonald's coffee. The woman was awarded close to $3 million, although she later settled the case for substantially less. After this case was resolved, I traveled to Argentina to address the national association of corporate lawyers. While in Buenos Aires, I visited a local McDonald's and purchased a cup of coffee. Printed in four places on the small cup in bright red letters were warnings that the coffee was hot: "PRECAUCION: CALIENTE!" These warnings were no doubt prompted by a legal decision in a country

that, while far away in a geographic sense, has become much closer legally to the rest of the world.

Difficulties with the Fight Response

Flight from legal concerns—through settlement of specific cases or movement of business operations to a supposedly friendlier legal environment—is often unrealistic in a global economy. The other option engrained into our genetic code is to stand and fight. There are two legal contexts for legal battles, each representing a different form of government regulation of business: specific cases in which court decisions represent a form of business regulation and larger legislative and regulatory arenas in which law reform battles are fought.

The option of fighting specific cases has already been covered, in the course of discussing the settlement of cases. That discussion noted problems with litigating individual cases. In cases where your company is a sole defendant, litigation costs are substantial even when you are confident that you would win at trial. And cases with two defendants can create a prisoner's dilemma scenario, in which a decision to litigate may be irrational, at least when the defendants do not communicate with each other. A decision by both defendants to litigate also makes it easier for a plaintiff's attorney to prove that they were at fault. In their attacks on each other, the defendants prove the plaintiff's case, leaving only the question of which of them should bear all or most of the liability. For example, to the plaintiffs' delight, defendants Ford and Firestone are pitted against each other in hundreds of personal injury lawsuits filed against them for injuries resulting from the use of Ford sport-utility vehicles equipped with Firestone tires.

This section will concentrate on the larger arenas in which the battle for law reform takes place. At first glance, law reform would seem to offer an opportunity to secure competitive advan-

tage by lowering a company's legal costs. However, just as two-defendant litigation might produce a prisoner's dilemma, law reform creates another form of dilemma called the public goods dilemma. The dilemma is that the outcome of law reform—say, a change in workers' compensation law that reduces company payments considerably—is a public good. As such, the new law benefits all companies, whether or not they invested their time and money in the reform effort. As professor Leigh Thompson of Northwestern University bluntly notes: "Those who fail to contribute are known as defectors or free riders. Those who pay while others free ride are affectionately known as suckers."[18]

Even when all companies in a particular industry contribute equally to law reform that benefits only their industry (in other words, when there are initially no free riders), the reform might provide little or no competitive advantage to your company. For instance, a reduction in workers' compensation payments might make the industry as a whole more profitable, but companies will not share equally in these profits. The lion's share of the profits will go to the companies that, as Porter puts it, create superior value for their customers by offering lower prices or unique benefits while keeping costs down. And the increased profitability of the industry may well attract new competition, free riders from the outside.

Efforts to improve the legal system are often noble and necessary to improve the national economy. Before your company invests resources in reform initiatives, however, you should carefully analyze the goal of law reform. If your goal is to serve a higher purpose, such as benefiting society, then your efforts might be justified. But if your goal is to increase your own competitive advantage, you should carefully answer the question: "What's in it for my company?"

In some cases a change in the law may provide your company with direct competitive advantage. For instance, time limits protecting intellectual property are sometimes extended in a

way that protects specific products. In 1998, the life of copyrighted works was extended from seventy-five to ninety-five years, a change supported by Disney Corporation to protect its exclusive rights to Donald Duck and Mickey Mouse. Suddenly Disney competitors were playing on a different field. In the words of Wharton professor G. Richard Shell: "There has been a lot of legislative maneuvering to gain competitive advantage. To use a football analogy, it's like making first and goal and suddenly finding they have lengthened the field by 30 yards."[19] But in other situations, where there are no specific benefits, it is easy for companies to become so enthusiastic about a cause that they overlook the fact that the benefits do not provide competitive advantage.

Thus all four conventional approaches to legal problems depicted in Figure 1.1 are flawed:

- Settling specific cases can encourage future litigation or invoke the prisoner's dilemma.
- Moving your company is often unhelpful, given the global convergence of law.
- Fighting specific cases is often not cost-effective.
- Investing in law reform might benefit your industry or the country in general without creating competitive advantage for your company.

The Manager's Legal Plan

The picture that emerges from a review of the conventional flight-or-fight approach to legal problems is common throughout the business world. Managers faced with myriad business concerns frequently take a reactive approach to legal problems. In this reactive posture, the traditional flight-or-fight responses are often unsatisfactory, for the reasons just described. Given their reactive stance, it is not surprising that managers often

view law as an obstacle and that they tend to mentally separate legal concerns from the issues that are considered more central to competitive advantage.

A problem that underlies this managerial mindset toward the law is that managers often feel incapable of creating a plan for dealing with legal matters. But a plan does not have to be great or perfect; even a faulty plan can be better than nothing. Albert Szent-Gyorti, Nobel Laureate in medicine, tells the story of a military reconnaissance team that was lost in the Swiss Alps following a snowstorm. The soldiers had given up hope of returning to their main unit alive when one of them discovered a map in their equipment. Having the map calmed the soldiers and, with the sense of direction provided by the map, they found their main unit. Upon their return, they showed the map to their lieutenant, who discovered that it was a map of the Pyrenees, rather than the Alps.[20]

This story illustrates that a leader does not need a perfect legal or strategic plan to calm employees and get them moving in the right direction. When a manager is faced with a confusing situation, be it a rapidly changing legal environment or new forms of competition, simply having a plan is often enough to inspire action that can lead to positive results. As noted by Karl Weick, my colleague at the University of Michigan Business School and one of the world's leading organizational theorists: "Followers are often lost and even the leader is not sure where to go. All the leaders know is that the plan or the map they have in front of them are not sufficient to get them out. What the leader has to do, when faced with this situation, is instill some confidence in people, get them moving in some general direction, and be sure they look closely at cues created by their actions so that they learn where they were and get some better idea of where they are and where they want to be."[21]

Taking action, any action, is often better than the paralysis and confusion that can result when managers encounter legal

problems. In this spirit, the following four-step Manager's Legal Plan is intended to enable managers to move from a reactive approach toward legal concerns to an ability to actively use the law to uncover and develop new forms of competitive advantage.

The first two steps of the plan build on the conventional approach that managers currently use in addressing legal concerns; the third step represents best practices of leading companies; the last step goes further.

Step One: Understand the Law

The conventional first step in addressing a legal problem is to meet with your attorney to discuss your legal rights and obligations, as you would do in handling your wrongful termination lawsuit. Step One in the Manager's Legal Plan is similar, except that the scope of the conversation goes beyond the specific litigation to a broader understanding of the law. You should, for instance, ask your attorney to provide a broader perspective on wrongful discharge lawsuits. What are they? What theories do plaintiffs assert in general (even though they are not all raised in your lawsuit)? What types of liability are associated with these lawsuits? And so on.

As discussed in later chapters, an obvious reason for this broader legal briefing is to prevent future litigation. Beyond this goal the broader briefing is essential to your career growth. As you move higher in the organization you will increasingly face business decisions that have legal implications. You will also discuss legal matters with a variety of parties, including customers, suppliers, employees, government officials, the media, shareholders, the board of directors, and creditors. According to Ben Heineman, senior vice president of General Electric, "People who lead corporations need to have an appreciation for the whole public side of their job as they go higher and higher up the ladder. Law [is] a significant part of any corporate entity's

life."[22] A former CEO of General Motors reputedly put it more bluntly: "My lawyer and I go steady."

Because managers need to understand the law, one of your most important resources is an attorney who has the ability to teach. A survey of CEOs by the American Corporate Counsel Association concluded that the most important role of a corporate attorney is that of an educator on legal issues.[23] The study of business law is also an important facet of a manager's formal education. In the United States, the legal environment of business is a key component of undergraduate, MBA, and executive education. Outside the United States, the importance of understanding business law is highlighted by the fact that a major in law is a popular alternative to a business major for students who intend to become managers.

Step Two: React to Legal Problems Through Flight or Fight

The second step is much like the conventional approach to legal problems. That is, your flight-or-fight mechanism will trigger an attempt to use one of the solutions summarized in Figure 1.1. While resort to one of these solutions is often inevitable, you should keep in mind their limitations in the global economy, as described earlier in this chapter.

Step Three: Develop Business Strategies and Solutions to Prevent Legal Problems

The third step in the Manager's Legal Plan goes beyond the traditional approaches by searching for business strategies and solutions to legal problems, rather than flight-or-fight solutions. While this sounds like a logical next step, especially when the flight-or-fight response fails, managers commonly forget to apply sound business judgment when faced with legal decisions. I have observed this phenomenon in a legal decision-making exercise

that I have used in my work with hundreds of experienced managers and MBA students. When faced with a litigation decision, these executives and students become so focused on the legal issues that they forget to use a financial analysis that includes calculation of net present value and opportunity costs. As a result they frequently decide to continue litigation that, from a business perspective, should be settled.

But Step Three goes beyond applying business tools to litigation. For example, a manager confronted with wrongful discharge litigation would take action that moves beyond the narrow decision to settle or fight. As discussed in greater detail in Chapter Three, the company's hiring practices should be reviewed, company documents should be revised, and employees should receive training that will prevent them from making statements that could result in liability.

Step Four: Climb to the Balcony—Reframe Legal Concerns as Business Concerns

It is tempting to conclude the Manager's Legal Plan at Step Three. After all, once you have completed the three steps, you have a broad understanding of the legal problem, you have exhausted flight-or-fight options, and you have applied best business practices in an attempt to resolve the problem.

However one remaining question has been overlooked: Is your problem solely legal in nature? In other words, are you framing the problem correctly? Mental frames that help us simplify and organize the complexity in our world are necessary for rational decision making. But simplification often comes at a cost. In viewing the world through a particular window, such as the window provided by a legal problem, we see only part of the landscape. In narrowing the scope of our vision, we risk what decision researchers call frame blindness, which is similar to the blind spot in a car's rearview mirror. By failing to take into ac-

count the entire picture when making decisions, we often overlook the best options.[24]

Your challenge as a manager, when dealing with a problem that appears to relate narrowly to a particular function—whether law or marketing or finance or manufacturing—is to step back from the details of the problem and attempt to broaden the frame. This book will provide numerous examples of the art of reframing "legal problems" as business opportunities. In his book *Getting Past No,* author William Ury uses the phrase "going to the balcony" as a metaphor for the mental detachment that is necessary when you are attacked or rebuffed by the other side during a negotiation.[25] In your role as a manager, a trip to the balcony can give you a broader perspective of the entire playing field without the blind spots that hinder your decision making when you are closer to the action. This broader perspective may enable you to reframe what you originally thought was a legal problem as a business opportunity. This, in turn, will allow you to generate new options for gaining competitive advantage. Though you may be unable to reframe every legal problem that you face, the attempt should at least encourage you and others in your organization to think about where you are and where you want to be—much like the map of the Pyrenees that saved the reconnaissance team lost in the Alps.

■ How This Book Is Organized

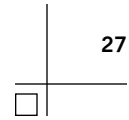
The chapters that follow will apply the four steps of the Manager's Legal Plan to legal issues that relate to various stakeholder groups—parties with an interest in your company. In creating value for the owners of your company, the shareholders, you must manage relationships with a variety of other stakeholders in a cost-effective manner. Especially important among them are your customers, your employees, and society at large, represented

by government. The Manager's Legal Plan will be used to explore the most controversial legal problems relating to these stakeholders. Chapter Two will focus on customers' product liability lawsuits, as well as hidden new product opportunities represented by this type of litigation. Chapter Three will address several legal matters relating to employees—workers' compensation, wrongful discharge, and sexual harassment—and how the changing nature of the employment relationship might produce opportunities for retaining the talent that is essential for business success. Chapter Four will show that even government regulation as stringent as environmental regulation can create opportunities for competitive advantage. Since specific legal plans will vary across companies and industries, the goal in each of these chapters is not to provide a definitive list of solutions. But these chapters will offer concrete examples of ways in which the Manager's Legal Plan can generate opportunities for competitive advantage.

Beyond the controversial issues covered in Chapters Two through Four that relate to key company stakeholder groups, several generic legal matters apply to a wide variety of legal concerns. For instance, given the importance of the law to business success, how can you ensure that you have the best legal resources and that you are maximizing the value of your legal talent? What tools are available for you to resolve disputes and how can you use systems design to best apply these tools? And how can your use of the law to achieve competitive advantage encourage ethical decision making within your company? These questions will be addressed in Chapter Five.

CHAPTER SUMMARY

Law plays an important role in achieving competitive advantage, as it enables companies to achieve cost reduction and develop products that are either unique or priced lower than those of competitors. However, con-



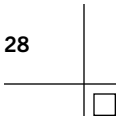
ventional "flight-or-fight" approaches to legal problems do not allow managers to make best use of the law to gain competitive advantage. For example:

1. Settling cases might encourage future litigation. Additional problems, in the form of the prisoner's dilemma, arise when a company has a co-defendant.
2. Moving the company to a friendlier legal environment does not work in a global economy for two reasons. First, as a result of the cross-border movement of goods, services, and investments, companies are increasingly subject to legal rules and regulations beyond their home country. Second, convergence of legal rules has become more common. Substantive law has converged in the areas of contract law, product liability, environmental law, securities regulation, sexual harassment, and anti-bribery law. Convergence has even occurred in areas relating to the legal process that once distinguished the United States from the rest of the world: jury trials, punitive damages, legal expenses, contingency fees, discovery, and class actions.
3. Fighting individual cases often does not make economic sense when they can be settled for less than the cost of litigation.
4. Fighting for law reform also may not make economic sense absent the potential for competitive advantage. As a result of the public goods dilemma, for instance, a company's investment in law reform might benefit free riders.

Given drawbacks with conventional approaches to legal problems, a new approach is necessary to maximize the use of law to gain competitive advantage. This new approach, called the Manager's Legal Plan, involves the following four-step process:

Step One. Understand the law in a broad sense, rather than just the specific issues you face when addressing a legal concern.

Step Two. Determine whether the conventional "flight-or-fight" approaches listed in Figure 1.1 can be used to resolve your legal problem.



Step Three. Develop business strategies and solutions to minimize future legal problems.

Step Four. Reframe legal concerns as business opportunities.

The chapters that follow will provide specific examples of how this plan can be used to achieve competitive advantage.

Questions to Consider

1. When you introduce a new product, do you think globally about the law and the impact of rules and regulations in countries where the product will be marketed?
2. When your company invests in law reform, do you consider the public goods dilemma and the advantages that the reform will provide to your company, as opposed to the industry in general?
3. Do you have a plan for using the law to achieve competitive advantage?
4. After a legal problem has been resolved, do you use your experience to prevent recurrence of the problem?
5. Do you ask your attorneys to provide you with a broader perspective on the legal matters that require your decision?
6. Do you attempt to reframe legal problems as business opportunities?