FOR MANAGERS, THE CHALLENGE OF UNDERSTANDING NONMARKET FORCES -- GOVERNMENT, INTEREST GROUPS, ACTIVISTS, AND THE PUBLIC -- IS FREQUENTLY more difficult than understanding the market environment. The author develops a strategy system of principles, frameworks, and action plans to deal with the issues, institutions, interests, and information that characterize the nonmarket environment. He uses the concept of a rent chain, analogous to the value chain, to show how companies can participate in policy-setting processes and generate leverage to their own benefit.

Why do some well-formulated competitive strategies run into roadblocks or end up being stalled by government inaction? Why do some strategies produce unintended consequences inconsistent with a company’s core values? Why are strategies sometimes criticized by the public
and threatened by government action? The causes of these problems are frequently found not in a company's market environment but instead in forces outside its markets. Indeed, for many companies, market success depends not just on their products and services, the efficiency of their operations, their internal organization, and the organization of their supply chains, distribution channels, and alliance networks. Success also depends on how effectively they deal with governments, interest groups, activists, and the public. The forces these parties generate can foreclose entry into new markets, limit price increases, and raise the costs of competing. They can also unlock markets, reduce regulation, handicap rivals, and generate competitive advantage.

These forces are manifested outside of markets but often work in conjunction with them; I refer to them as nonmarket forces. The nonmarket environment consists of the social, political, and legal arrangements that structure interactions among companies and their public. For many companies, nonmarket forces have a major impact on performance; hence these forces warrant the same high level of attention in business strategy as do market forces. A business strategy must help a company navigate in both its market and nonmarket environments and is composed of a market or competitive component and a nonmarket or public component. Managers may understand the market environment relatively well but often see the nonmarket environment as posing different, often more difficult, challenges.

To address nonmarket forces effectively, managers must formulate specific strategies to deal with them. Nonmarket forces and the institutional arenas in which they are manifested are sufficiently different from market forces that they require a nonmarket strategy system for effectively managing interactions with the nonmarket environment. That system, a component of a larger strategy system, consists of a process to structure analysis and strategy formulation, theories and conceptual frameworks to guide that formulation, and issue-specific strategies and action plans. The product of the system is a nonmarket strategy tailored to the company's market and nonmarket environments and integrated with its competitive strategy, core values, and distinctive competencies.(FN1)

In this paper, I characterize the nonmarket strategy system by identifying a process for management in the nonmarket environment, an approach for moving from guiding principles and conceptual frameworks to action plans in the context of that process, and specific theories and frameworks for managing in the nonmarket environment. Instead of presenting a catalog of theories and frameworks, I use one framework -- a rent chain -- and the underlying theoretical construct -- distributive politics -- as an illustration. First, however, I identify a number of differences between the nonmarket and market environments to indicate why nonmarket analysis and strategy formulation warrant a specific approach and careful attention.

THE MARKET AND NONMARKET ENVIRONMENTS

The nonmarket environment differs from the market environment in a number of ways:

Markets are an institution through which economic exchange is organized in a system of property rights governed by a unanimity rule. The nonmarket environment includes public
institutions, which are characterized by majority rule, due process, broad enfranchisement, collective action, and publicness, i.e., actions are typically in full view of the public.

In markets, those enfranchised are the participants in economic exchange. In contrast, those enfranchised in the nonmarket environment generally include not only market participants but also government officials, interest groups, activists, the media, and the public. These parties often set a firm’s nonmarket agenda.

Actions in markets are voluntary and produce private benefits. In contrast, actions in the nonmarket environment typically provide public benefits that affect a broader group of parties. For example, congressional legislation affects not only those who lobbied but all to whom the legislation pertains. This means that the free-rider problem is more prevalent in the nonmarket environment than in the market environment. (FN2)

In market competition, resource commitment is often the key factor in determining outcomes. In nonmarket competition, votes are often the key factor, but they do not reflect the intensity of preferences the way the commitment of private resources does. That is, where dollars count in the market environment, numbers of constituents (voters) count in the nonmarket environment.

Some actions prohibited in the market environment are allowed in the nonmarket environment. Collusion among firms in an industry is generally illegal, whereas collusion or cooperation among firms is generally permitted in governmental arenas. For example, trade associations cannot coordinate their members’ market activities, but they can coordinate the lobbying by their members on a bill before Congress. (FN3)

Performance in the market environment is evaluated in terms of profits generated or value created, whereas those in the nonmarket environment who evaluate company performance use broader dimensions that include ethical principles and concepts of responsibility.

These differences imply that the theories and conceptual frameworks for assessing the market environment and analyzing and formulating strategies must be supplemented with approaches that explicitly take these differences into account.

The market environment is characterized by the number of industry rivals, the ease of entry and exit, cost structures, the nature and rate of technological progress, the nature of demand and dimensions of competition, and the rules of market competition, including antitrust law and regulation. (FN4) Market analysis focuses on industry structure and performance, distinctive capabilities and competencies, and market segments. The foundations for competitive strategy are provided by the discipline of economics as applied in competitive analysis. The step from analysis to strategy involves, for example, assessing the ability of a company to deal with Porter’s five forces, and strategy formulation focuses on selecting generic competitive strategies and choosing specific courses of action. (FN5)

The nonmarket environment is quite different. It can be characterized in terms of issues, institutions, interests, and information. For example, in telecommunications policy, a specific issue is the bill introduced in Congress to allow the Regional Bell Operating Companies (RBOCs) to
produce telecommunications equipment by overturning a portion of the Modified Final Judgment (MFJ) that settled the federal antitrust suit against AT&T. The Federal Communications Commission, congressional authorization committees, state regulatory commissions, and the federal courts are the cognizant institutions for telecommunications issues.

Interests are individuals and groups with preferences for or a stake in a particular issue. (FN6) In the case of telecommunications, interests include telecommunications companies, able TV companies, media organizations, and equipment manufacturers. Consumer, labor, and activist groups are also involved. Interests can be aligned or opposed on an issue. The equipment manufacturing bill was supported by the RBOCs and opposed by AT&T and media organizations.

Information is what interested parties know about the relationship between actions and consequences and about the preferences and capabilities of the interested parties. A nonmarket strategy then is the concerted action of an interested party directed at a nonmarket issue that is a subject of competition in the cognizant institutions where information typically plays an important role.

To identify the counterparts to competitive analysis and strategy, consider the issue of telecommunications policy reform. The counterpart to competitive analysis is the analysis of interests, the potential benefits from taking political action such as lobbying and grassroots activities, the costs of taking political action, and the effectiveness of alternative actions. The actions of these interests compete in the institutional arena of Congress, with members of Congress as their focus. The principal disciplinary foundation for this analysis is political economy, and the relevant theory is distributive politics.

The theory of distributive politics is based on a structured pluralism perspective in which interests are recognized as diverse and competing for benefits in the context of institutional arenas. The focus of analysis thus is on the distributive incentives for political action, the costs of collective action, and the constituent connection that links interests to the reelection concerns of members of Congress. (FN7) In its simplest form, the analysis focuses on the amount of pressure interests are able to bring to bear on members of Congress, and the outcome of an issue depends on the pressure generated by the interests and on the structure and procedures of Congress. (FN8)

Analysis of the competition over telecommunications policy draws on components of the theory of distributive politics. Those components include the median voter theorem, social choice theory, the theory of rational ignorance, the iron triangle and capture theories of bureaucracy and regulation, strategic trade theory, including protectionist and market opening strategies, the theory of collective action, and the theory of lobbying. (FN9) The analogs of generic competitive strategies are basic strategies for addressing specific nonmarket issues in the context of particular institutions. The step from analysis to strategy focuses on the choice of actions given the anticipated actions of other interests. That is, the analysis that provides a basis for formulating nonmarket strategies is specific to the issue, the institutional arenas in which it is addressed, the interests likely to be active on the issue, and the information that the interests and the institutional
officeholders have about the relationship between actions and outcomes. I illustrate this with examples and elaborate on the framework of distributive politics through a discussion of the rent chain. I also consider the effectiveness of nonmarket strategies in the context of the rent chain.

A critical factor in formulating effective nonmarket strategies is viewing the nonmarket environment as endogenous both to market forces, such as technological change, and to the nonmarket activities of firms and other interests. Competitive analysis typically takes the rules of the game -- the regulatory system, for example -- as given, whereas the nonmarket strategy perspective views these rules as endogenous and hence the focus of strategy. Robert Galvin, head of Motorola for more than three decades, addressed the use of nonmarket strategies in shaping Motorola's market environment as "writing the rules of the game."

The first step in any defined strategy is writing the rules of the game honorably and fairly in a manner that gives everyone a chance with predictable rules. Our company has started industries. We have helped write standards. We have helped write trade rules. We have helped influence policies. We have helped write national laws of countries where we have engaged, always in a respectful way. We have never taken for granted that the rules of the game would just evolve in a fashion that would make for the greatest opportunity. We have incidentally found that in many quarters of the world, our offer to constructively define the rules is reasonably welcomed. With the right rules of the game, one's opportunity for success is enhanced.(FN10)

Galvin's point is not that companies dictate the rules of the game but rather that those rules are shaped by the strategies of interested parties and by the governing institutions. Companies such as Motorola and leaders such as Galvin attempt to shape the rules, just as other interested parties do.

NONMARKET ANALYSIS AND STRATEGY FORMULATION

Nonmarket strategies result from a management process that incorporates knowledge of the market and nonmarket environments, information about specific issues, and conceptual frameworks that guide strategy formulation and implementation. I now discuss a process for addressing nonmarket issues using the example of Levi Strauss & Co., which, in response to changes in its market strategy, faced an inconsistency between its fundamental ethical principles and its relationships with foreign suppliers.

LEVI STRAUSS AND GLOBAL SOURCING GUIDELINES

Levi Strauss, a privately owned firm, has integrated the core values of the Haas family into its internal policies and earned a reputation for adherence to ethical principles and concern for its stakeholders. In the 1980s, the company made two important changes in its business strategy. It broadened its product lines, particularly into casual wear, and expanded internationally in both its markets and sourcing. The expansion of its markets and product lines, sales growth in the United States, and pressures for low-cost sources of supply resulted in rapid expansion in the number of offshore suppliers. Levi Strauss quickly found that its garments were no longer coming primarily from its own facilities but from more than 700 foreign suppliers.
considerations are likely to dominate.

These examples pertain to the rent chain's configuration, which frequently centers on the location of facilities, suppliers, and alliance partners. Although the rent chain can be configured to provide varying degrees of nonmarket productivity, doing so may affect its market productivity. Locating research facilities in Japan may be more costly than concentrating research in the United States but may be necessary for effective participation in Japan's administrative and consultative processes. A company thus has to trade off the productivity of rent and value chains on both market and nonmarket dimensions. This trade-off depends on the significance of market and nonmarket forces for performance.

THE RENT CHAIN AND CONCERTED ACTION

When a company's rents are affected by a nonmarket issue, the rents of other components in the chain may also be affected. A price increase for a component used in production benefits the supplier and harms the purchaser, so their interests are opposed. On many nonmarket issues, however, interests are aligned, as when the nonmarket issue affects demand for a company's products. In this case, the company, its suppliers, and its distributors may all benefit from an increase in volume. Interests are then aligned along the rent chain, and hence there is a potential for concerted action. In this section, I use the concept of the rent chain to assess that potential.

When there is alignment of interests along a company's rent chain, the potential for concerted action is vertical. When Motorola sought entry into the cellular telephone market in Japan, its rent chain from its other operations in that country was a basis for concerted action. In addition, its business partners, which purchase transmission station equipment and hand-sets, had aligned interests and incentives to act in concert with Motorola.

A nonmarket issue can also affect the rents of an industry or sector, and, in that case, the potential for concerted action is horizontal. The telecommunications sector accord between the United States and Japan was intended to open the Japanese equipment market to foreign suppliers, including Motorola, and provided the potential for concerted action through the rent chains of equipment manufacturers. The Clinton administration's attempt to open the Japanese automobile and parts markets to foreign suppliers is another example. A horizontal potential for concerted action thus encompasses components of a set of vertical potentials.

Some nonmarket issues affect more than one industry, and, in that case, the potential for concerted action is multisector. The Clinton administration's effort in 1994 to reach a trade agreement with Japan on specific sectoral import targets for a number of industries, including autos, telecommunications, and financial services, was a multisector issue. Multisector potential for concerted action can encompass the horizontal potential of several sectors, which, in turn, can encompass the vertical potentials arising from the rent chains of the companies in those sectors. These potentials are thus nested (see Figure 4). Which level in this nesting is relevant is determined by the nonmarket issue, as the three trade examples illustrate.

The nonmarket productivity of the rent chain depends on the nature of the issue. When the
issue is entry into the cellular telephone market in Japan, the relevant (vertical) rent chain is that of Motorola and its joint venture partner (see Figure 4). If the issue is a telecommunications sector accord with Japan, the relevant (horizontal) rent chains are those of U.S. equipment manufacturers, which include Motorola in cellular equipment, AT&T in switches, and defense contractors in communications satellites. If the issue is a multisector trade accord with Japan, the relevant (multisector) rent chains are those of all the present and potential exporters in those sectors. Indeed, the U.S. trade negotiation process regularly includes exporters in consultation and policy processes as well as in trade delegations.

Figure 4 focuses on directly aligned interests, but coalitions can also be composed of interests that are seemingly quite different yet work together to the advantage of each. The telecommunications equipment manufacturing bill was opposed not only by AT&T but also by newspapers, cable TV companies, and information services companies, which wanted the legislation to fail because passage might have made other aspects of the MFJ likely targets of legislation. The coalition was able to have greater impact than the sum of its parts because its members acted in parallel, even though they were potential rivals in numerous business areas. Similarly, the RBOCs formed a coalition to overturn the MFJ, even though they recognized that if their efforts were successful, they would soon be competitors.

Some groups have both aligned and conflicting interests, depending on the issue. Semiconductor Industry Association members include both manufacturers of semiconductors and their customers. The members agreed to file a Section 301 petition to open the Japanese market to foreign semiconductors, since it was not harmful to any members and benefited many. The members, however, disagreed on Motorola’s proposal for a tariff on semiconductor imports. The interests of semiconductor manufacturers and users were in direct conflict on that proposal. (FN19)

The nature of the issue also determines how companies address it (see Table 1). Multisector issues are most likely to be addressed by peak associations such as the Chamber of Commerce, the National Association of Manufacturers, and the National Federation of Independent Business (NFIB), and by industry or trade associations, to the extent that the issue has different effects across industries. Often a peak association works for efficiency, as in the support of liberalized trade. Horizontal or industry-level issues are addressed by industry associations as well as individual companies. If an issue has differentiated effects, a company typically pursues competitive advantage. Vertical or single-chain issues often affect a company’s competitive position in its industry, and its efforts are then directed at preserving or enhancing competitive advantage. Next I discuss the relationship between the scope of issues and the organization for addressing them in the case of health care reform and the pharmaceutical industry.

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