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Nonmarket Strategy in Business Organizations

A Global Assessment

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Preface

When I was an undergraduate three decades ago, business strategy was mostly about markets: build a better product or produce efficiently and your organization is likely to succeed. Political and social *nonmarket* factors were also considered but only on the periphery.

Today, nonmarket concerns have become much more prominent. On the political side, many firms support trade associations, hire former government officials, negotiate with bureaucrats, and lobby politicians directly to erect favorable or modify unfavorable regulations. On the social side, firms are expected to contribute to charities, promote environmental sustainability, and help build stronger societies. For many firms, an effective market strategy alone is no longer sufficient.

This shift in thinking is significant for several reasons. Existing scholarship suggests that political and social nonmarket strategy (NMS) can drive performance; many executives apparently agree, or they would not be investing so heavily in this arena. Many firms integrate nonmarket considerations into the market strategy, so understanding the influence of political and social intervention is critical as well. But there are fine lines between managing the political arena and cronyism, and between genuine social responsibility and image management.

Consider Tesla. CEO Elon Musk claims that the large subsidies his company receives to produce electric cars are part of a public-private partnership to propel the transportation industry into a green future. But critics do not understand why market forces require taxpayer support to develop the best technologies and view the entire process as corporate welfare. Tesla provides a prominent example of NMS, but many other companies also address political and social intervention strategically, often in subtle ways.

NMS is a multifaceted construct that extends from individual firms to governments, economic systems, and societies in general. Cronyism is often linked directly to firm-level political intervention, but widespread corruption also creates an environment conducive to more political NMS. This viscous cycle of government-level corruption and firm-level nonmarket intervention is not only a problem in developing nations but in the world's most advanced economies as well.

An NMS that appears to be effective for one firm may not be for another because of differences related to top management, firm size, resources, industry, competitors, and other factors. Nonetheless, there are key principles that govern relationships between NMS, market strategy, strategic capabilities, and firm performance.

This book seeks to clarify NMS for both scholars and practicing managers. It adds context by surveying managers in ten disparate countries and testing models that integrate emphasis on strategic capabilities, market and nonmarket strategies, and financial and non-financial performance. This book integrates a scholarly foundation with practical examples to provide a structured means of understanding NMS and its growing prominence. It does not answer every question about NMS, but it offers both academic and real-world insights.

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Chapter 1
Introduction

Prior to the early nineteenth century, most of the world's population was employed in agriculture and was, by today's standards, poor. The industrial revolution forever changed this trajectory, shifting workers from fields to factories and promoting a steady increase in the standard of living. To benefit from the industrial revolution, societies needed access to emerging technology and to investors with the freedom and financial resources to produce. They also needed the respect for private property and open markets. As a result, the USA, the UK, and other European nations were among the first to develop as largely capitalist societies and have remained global economic leaders. Japan, South Korea, China, and others have embraced free enterprise to varying degrees in the years since. Their economic ascensions have been varied and more recent, but no less remarkable.

Inherent in capitalism and the industrial revolution was the idea that private firms succeed when individual needs are met through relatively *free exchange* between buyers and sellers through mechanisms commonly known as *markets*. The advances that resulted from this thinking are remarkable. During the last two centuries, the world has become a hundred times wealthier, basic literacy has increased from 12% to 85%, life expectancy has risen from 30 years to 71, and the proportion of people living in a democracy has increased from 1% to over 50%. Harvard Professor Steven Pinker (2018) attributes this progress to the enlightenment, a replacement of dogma, tradition and authority with reason, debate, and the pursuit of truth. But enlightened thinking and action cannot flourish in repressed societies. Built on human freedom, science, technology, and innovation, capitalism is a natural extension of the enlightenment.

A thriving private sector inherent in free enterprise does not solve all of society's problems, but it generates a surplus of resources that can be employed to address many of them either through market activity or directly through government intervention. Today's advanced societies can afford clean air and drinking water, advanced communication networks, and a broad access to healthcare, amenities reserved for the wealthy in past generations. The notion that business firms should focus primarily on returns to investors and satisfying customers by producing

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goods and services for which they are willing and able to pay enhances quality of life across the board. Market concerns were primary within this traditional view of free enterprise. Corporate philanthropy, social intervention, and other nonmarket activities were secondary.

The discipline of marketing followed this line of thinking during the past century and has developed around the notion that satisfied customers are key to long-term financial success. Retail legend Harry Selfridge elevated customer satisfaction to the forefront in 1909 when he proclaimed, "The customer is always right" (Skapinker 2010). Widely recognized as a showman, Selfridge understood the essence of social and political influences on business activity but viewed customer satisfaction as a key indicator of social progress and as the primary trigger of investor returns (Woodhead 2013). Within this notion of a *market orientation*, firms should concentrate their strategic efforts on customer preferences, product/service quality, costs, and other *market* factors, with a focus on financial returns, including both profits and shareholder value. This primary view of business purpose and activity was generally accepted in the most advanced societies through most of the twentieth century.

The emphasis on customers touted by icons like Selfridge spread in the decades that followed. In 1979, retail brokerage firm Smith Barney (now part of Morgan Stanley) launched a memorable series of television ads featuring John Houseman with the catchphrase, "They [the brokerage] make money the old-fashioned way. They *earn* it" (see https://www.youtube.com/watch?v=yAMRXqQXemU). Although not a direct reference to capitalism, the Smith Barney ad campaign exemplified the direct, no-nonsense perspective of business success through market orientation. Consumers still expect firms to earn their keep by producing better quality and less expensive wares, but their expectations have become much more complicated.

The Nonmarket Strategy Nomenclature

Before proceeding, it is important to identify and distinguish among multiple related but distinct terms. As previously mentioned, *markets* are mechanisms that allow buyers and sellers to exchange freely. Nations that permit markets to function with limited government intervention are called market economies. In a broad sense, the alternative to a market economy (i.e., capitalism) in an organized society is central planning, often called socialism, collectivism, Marxism (named for one of socialism's great intellectuals), or statism. The capitalism-socialism dichotomy is a useful means of thinking about the economy, although it is an overgeneralization. At a minimum, capitalism and socialism represent opposite ends of a continuum. In this respect, a market approach to economics is a matter of degree, not kind. The Heritage Foundation's *Index of Economic Freedom* (www.heritage.org/index) and the Cato Institute's *Human Freedom Index* (www.cato.org/human-freedom-index)—examined in greater detail in future chapters—approach individual freedom and economic development in this manner, applying scores to each nation along clearly identified criteria.

The world's most advanced nations—including the USA and those in Western Europe, among others—are widely considered market economies, while centrally planned societies such as Cuba, North Korea, and Venezuela are socialist in orientation. Other nations are more difficult to classify, however. China is the quintessential example of this conundrum with an intermediate system often called state-sponsored capitalism, a literal oxymoron.

There are also issue-specific concerns with the market economy classification scheme. For example, in a strict market sense, highways could be privately maintained and financed by private tolls, education could be financed at the discretion and ability of parents, and all medical care could be arranged between individuals, hospitals, and private insurance companies. But some economists argue that certain types of government intervention in some areas actually promote the development of markets in others. New roads provide an infrastructure for transporting products, government schools promote an employment-ready workforce, and universal healthcare enables workers to change jobs and careers more easily. These debates will not be resolved in this book, but their existence is worth noting because they underscore the complexity involved in market systems.

Marketing is a broad term referring to activities designed to promote exchange, such as product development, pricing, promotion, and distribution. Marketing occurs primarily in market economies because firms must inform and persuade customers to succeed. Markets include multiple buyers and sellers, whereas marketing activities are undertaken by individual firms. While marketing endeavors tend to focus on markets and customers, they also include public relations and other nonmarket activities.

Market-oriented firms emphasize factors associated with markets and often engage in marketing in ways that highlight customer satisfaction. In a market economy, most private firms must be market-oriented save for the extent to which they can persuade politicians to protect them from competition. *Market strategies* acknowledge both industry and firm influences on performance and are concerned with customers, competitors, suppliers, and other entities that influence competitive advantage through strategic orientations, such as cost leadership and differentiation (Cadogan et al. 2002; van Raaij and Stoelhorst 2008). Put another way, market-oriented firms respect the market and compete aggressively through marketing, innovation, cost-cutting, and other means to win over customers who have choices.

Nonmarket activities include business undertakings outside of the market realm. Every business activity can be classified as market, nonmarket, or both, although this can be easier to do in theory than in practice. Arguably, distinctions between market and nonmarket organizational activities are more complex than those between market-oriented and centrally planned economies. Note that nonmarket is considered to be the alternative to market at the *micro* level—in the context of firm strategy—but the term is not widely used in the context of national economies. The alternative to a market orientation at the *macro* level is socialism.

Nonmarket strategy (NMS) includes such firm activities as broad social initiatives, lobbying, campaign contributions, and even direct collaboration with government agencies and regulators (Delmas and Montes-Sancho 2010; Lawton et al. 2013; Okhmatovskiy 2010). NMS can be broadly subdivided into social and political dimensions, a distinction made in this book. A firm can employ both market and nonmarket strategies, but market-oriented firms emphasize the former.

Contemporary Market and Nonmarket Dimensions

Satisfying customers and "building a better mousetrap" will always drive organizational success in a market economy. But today, emphasis on a *nonmarket* strategic dimension has expanded alongside the more traditional *market* dimension that focused primarily on business owners, customers, and suppliers as core stakeholders. Exactly when this shift in thinking entered mainstream academic and business thinking is uncertain, but nonmarket activity in firms began to gain noticeable traction in Europe and the USA during the 1970s and 1980s (Aplin and Hegarty 1980; Doz 1980; Baysinger 1984).

As previously mentioned, some business activities are difficult to categorize as either market or nonmarket. Human resources (HR) can considered part of the *market* equation because appropriate talent and a committed workforce are required to meet consumer needs and drive firm performance, a notion emphasized by former Southwest Airlines CEO, Herb Kelleher. For this reason, HR is often discussed as part of the market domain as well.

Other (nonmarket) stakeholders with a less direct impact on performance have also been added to the mix, including governments, communities, society at large, and even the natural environment. The once positive connotations of profit and wealth are now neutral at best; the wealthy are now "filthy rich," and high returns are often "excess profits." Today, many people expect firms to integrate and balance the views of *all stakeholders*—not just traditional market-oriented ones—when making strategic decisions (Lux et al. 2011, 2012). Some even expect firms to prioritize nonmarket objectives such as wages and working conditions, urban revitalization, and "saving the environment."

An evolving school of thought does not see market and nonmarket concerns as mutually exclusive. Its' adherents emphasize integration of the two realms into a broader, "enlightened" stakeholder perspective—often called "stakeholder theory" by academics—as a more effective long-term approach. Tools such as the balanced scorecard reinforce the notion that firm performance extends beyond profits by including non-financial measures such as customer satisfaction, organizational learning, and community support (Kaplan and Norton 2007; Schulte 2005).

Current Research on Nonmarket Strategy

Proponents of NMS argue that an effective nonmarket approach is not only good for society but is also good business. Indeed, mush of the current scholarship assumes the former and seeks to confirm the latter. Logically, numerous economic and management theories support the notion that emphasizing NMS improves firm performance (Parnell 2015; *Economist* 2016; Macher and Mayo 2015; Davis et al. 2010; Liu and Chen 2015). The aforementioned stakeholder theory focuses on the need for strategists to consider a wide range of groups—beyond suppliers, customers, and competitors—that influence and are affected by firm actions (Hillman and Keim 2001). Institutional theory emphasizes how governments and other institutions influence firm structure and strategy (Hadani 2012). Public choice theory highlights the fact that organizations pursue mutually beneficial arrangements (i.e., cronyism) with politicians and other government entities (Bonardi et al. 2005, 2006; Wood and Frynas 2006). The behavioral theory of the firm emphasized imperfect information, bounded rationality, and satisficing—settling on practical, workable decisions rather than seeking to maximize profits (Ji-Yub et al. 2011; Liu et al. 2015; Cyert and March 1963). The resource-based view (RBV) of the firm highlights roles played by governments and other external entities in amassing strategic resources (Wei et al. 2016). Each of these perspectives helps explain how and why an effective NMS enhances firm performance (Mellahi et al. 2016b; Dahan et al. 2013; Hadani and Schuler 2013), although none of them prescribe specific nonmarket actions.

Theories aside, the notion of an NMS-performance link is intuitive; nonmarket activity can promote positive relationships with stakeholders. Ostensibly, firms would not pursue NMS if a performance payoff was not anticipated, but this inference does not constitute evidence. Some firms do not prioritize NMS, perhaps because they do not understand the phenomenon or how to address it, or simply do not perceive a benefit in doing so. A growing body of scholarly research is evaluating factors that influence a firm's nonmarket emphasis, as well as the link between NMS and firm performance (Bach and Allen 2010; Baron 1995; Wei et al. 2016; Buli 2017). Mellahi et al. (2016b) reviewed 162 NMS-performance studies and found that 102 identified a significant link. Scholars are focusing more on underlying mechanisms that appear to influence *how* NMS drives performance, including how NMS might affect consumer perceptions of the firm (Luo and Bhattacharya 2006), access to financial resources (Madsen and Rodgers 2015), and even access to political resources (Frynas et al. 2006).

A positive NMS perspective views nonmarket action as a reflection of organizational strength and enlightenment. As such, political involvement is not just a means of countering government regulation, but also a proactive approach to societal development. From this perspective, social challenges such as water depletion, deforestation, and child labor exploitation occur when governments are unwilling or unable to foster responsible business practices (Scherer and Palazzo 2011;

Scherer et al. 2006). Given this void, interest groups pressure firms to engage in political activity by working with nongovernmental organizations (NGOs) and others to address insufficient social and environmental standards (Valente and Crane 2010). Hence, firms ultimately address the problems governments cannot or will not address. Conceptually, this view runs counter to the traditional expectation of firms as pursuers of profit through market means.

Within this positive NMS perspective, corporate social responsibility (CSR) is viewed as a building block of NMS because it can influence public policy in a manner consistent with the firm's social values (Liedong et al. 2015; Mellahi et al. 2016b; Scherer 2017; Scherer and Palazzo 2011; Schneider and Scherer 2016). The trust created between individuals and organizations when firms campaign for social change is presumed to benefit the firm economically as well. This perspective on proactive political interaction is known as political corporate social responsibility (PCSR) (Wickert 2016).

A number of scholars have promoted the PCSR perspective (Scherer et al. 2014, 2016; den Hond et al. 2014; Matten and Crane 2005), but others are wary (Liedong et al. 2015; Mellahi et al. 2016b; Scherer 2017; Scherer and Palazzo 2011; Schneider and Scherer 2016). A negative view of NMS sees nonmarket emphasis as an option pursued by firms unable to address market concerns effectively (Parnell 2015; Adly 2009). As previously noted, goals vary across stakeholders, and market and nonmarket conflicts are inevitable, requiring strategic managers to make choices (Cavazos and Rutherford 2012; Baron 1995; Hadani et al. 2015).

The positive and negative perspectives on NMS are associated with two broad research directions. Through a positive lens, strategic or political corporate social responsibility focuses on firm actions that seek to advance both social and financial goals (McWilliams et al. 2006). Through a largely negative lens, corporate political activity (CPA) emphasizes management of politicians and political institutions in ways beneficial to the firm (Hillman et al. 2004); social benefit is not necessarily a concern. Efforts to integrate these two disparate streams have been limited (den Hond et al. 2014; Hadani and Coombes 2015) and have contributed to a wide range of research perspectives and nomenclature (dos Reis et al. 2012; Funk and Hirschman 2017; Mellahi et al. 2016a; Vázquez-Maguirre and Hartmann 2013).

The positive and negative perspectives on NMS can be viewed as social and political dimensions, respectively. *Political NMS* is associated with lobbying, political engagement, and related activities (Iriyama et al. 2016; Néron 2016; Unsal et al. 2016). It is seen as a means of protecting the organization against a regime or attempting to influence one and typically carries a negative or neutral connotation. Scholars have investigated political NMS from several perspectives, including corporate political activity (CPA), strategic political management, and strategic political emphasis (Oliver and Holzinger 2008; Hillman and Hitt 1999; Hillman et al. 2004).

At the organizational level, CPA can advance firm interests, minimize the effects of government policies that threaten corporate goals, or maintain a favorable status quo (Baysinger 1984; Keillor et al. 2005; Lawton et al. 2013; Baines and Viney 2010). In their review of global work on CPA and performance, Rajwani