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Strategy Beyond Markets

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STRATEGY BEYOND MARKETS

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INTRODUCTION

Traditional strategy scholarship is fundamentally about understanding the choices firms make in markets to create and capture long run value. Scholars in this space study the actions and choices of firms by focusing on firm interactions with or responses to key market rivals and/or market-based stakeholders such as upstream suppliers, downstream distributors, and key employees. *Strategy Beyond Markets* research is also interested in how the actions of firms affect long run value. However, the scholars in the *Strategy Beyond Markets* field focus their attention on choices emanating from firm interactions with or responses to entities *beyond* their primary market stakeholders such as government regulators, community organizations, unions, advocacy groups, and policy makers. These *Beyond Market* stakeholders are numerous and each have their own wants, demands, or requirements of firms.

Typically *Beyond Market* stakeholders want firms to change the processes employed to implement firm market strategy or they desire resources from the firm to help meet their own objectives. For example, in the communities where firms are located, community leaders might ask firms to invest resources to improve education for local citizens or to help improve basic infrastructure. Activist environmental groups might boycott firms that do not redesign their supply chain to reduce toxic release into waterways. International nongovernmental organizations may protest firms that do not eliminate the use of resources acquired from locations where the NGOs observe violations of human rights. Trade associations may seek protective quotas on important raw material inputs for their member firms. Government regulators may attempt to require firms to improve safety for manufacturing employees or to invest in the best available technology to reduce air pollution emissions from production processes. Elected politicians may try to pass new laws that increase minimum wages paid to firm employees or laws that restrict entry by firms into industries. Courts may restrict the funding amounts and methods used by firms to interact with elected officials or rule on the protection of property rights affecting the firms.

In response to these pressures, firms design strategies to address the wants, demands and requirements of *Beyond Market* stakeholders. That is the focus of this special issue of the *Advances in Strategy Management*. We organize the papers in this special issue around three central themes: *Public Politics*, *Private Politics*, and *Integrated Political Strategy*. *Public Politics* research is concerned primarily with the strategies employed by firms to address *Beyond Market* stakeholders whose influence reflects their position in formal political institutions, namely public policy makers. Thus, *Public Politics* is concerned with the interactions between firms and government officials that have the authority to pass new legislation, promulgate regulatory rules or issue statutory interpretations (inter alia). By comparison *Private Politics* focuses on firm strategies to manage *Beyond Market* stakeholders that act outside of the public policy-making process. In the *Private Politics* field scholars explore strategies employed by firms interacting with special interest groups like activist environmental groups or international NGOs. *Integrated Political Strategy* scholars seek to identify comprehensive strategies that bridge *Public Politics and/or Private Politics* with market-based competitive strategy.

It is probably accurate to say that since the advent of markets and firms, various *Beyond Market* stakeholders have strived to change the behavior of firms. In the 1960s, firms in the United States experienced the proliferation of new public policies to improve employee health and safety, the environment, and consumer protection by mandating changes in firm behavior. These gave rise to the desire for more effective *Public Politics* as many firms realized that they could not simply be passive recipients of government regulation if they wished to thrive in the competitive marketplace. Many companies hired large legal staffs, engaged in lobbying, and adopted environmental, health, safety and compliance units.

Around the same period, many firms observed an increase in interest group activity to pressure them directly to address social and environmental problems voluntarily rather than through traditional public policy avenues. In their wake, *Private Politics* emerged. Standard setting efforts, trade association codes of conduct, community outreach, and public relations became common place. Earlier adversarial relationships between activists and firms were complemented by collaborative efforts and other attempts to mutually create value. More sophisticated firms began to recognize the value of *Integrated Political Strategies* that leveraged public and private politics and traditional market-based strategies.

Whether challenged through public policy or private pressure, managers see the effects on long-term profitability and have learned the importance of *Strategy Beyond Markets* as a component of firm strategy. The extent to which firms craft strategy to actively address *Beyond Market* stakeholders is increasing in importance. In a recent survey, McKinsey reported that over 95% of CEOs believe that society at large has increasing expectations that business must address and that business should be responsive to the wants, demands and/or requirements of *Beyond Market* stakeholders.[1] Additionally, nearly 60% of executives are explicitly focused on building and maintaining relationships with *Beyond Market* stakeholders.[2] Firms recognize that they must develop resources and capabilities to effectively manage *Beyond Market* stakeholders.

Executive recognition of the importance of *Strategy Beyond Markets* is a global phenomenon. The World Bank asked CEOs to rank the most important constraints for their firms when deciding to invest. The executives ranked the uncertainty of public policy as the second most significant constraint, ahead of more traditional market-based constraints such as identifying market opportunities, raising financial capital and attracting human capital.[3] Furthermore, each year the Conference Board asks CEOs to discuss the biggest challenges their organizations face to build the capabilities necessary to meet long-term objectives. Recent results from several annual Conference Board surveys of nearly 1,000 CEOs from across the globe reveal that *Private Politics* is growing in importance. By 2015, the survey showed that *Private Politics* (e.g., engaging with local community or engaging with special interest groups) was among the most important challenges CEOs face.[4] In a report entitled, "A marketplace without boundaries: Responding to disruption," PwC discusses the results of their 18th annual global CEO survey. In one question, PwC asked CEOs "How concerned are you about the following potential … threats to your organization's growth prospects?" The number one threat identified in the survey was the threat of government regulation. Nearly 80% of the CEOs surveyed identified regulation, and thus the importance of *Public Politics*, as a potential threat compared to about 55% of the CEOs identifying either new market entry or technological change as major threats. In a related question, CEOs viewed regulation as a greater potential disrupter to firm success than market threats such as increased competition, changes in consumer preferences, or supply chain changes. Interestingly, the view that regulation is a significant threat is shared by CEOs not only in highly regulated industries such as energy and pharmaceuticals, but also in traditionally less regulated industries such as entertainment and retail.[5] It is apparent from these recent surveys that executives view *Strategy Beyond Markets* as important as traditional competitive market strategy, and perhaps more important in some situations.

As David P. Baron points out in the opening paper in this volume, the academic interest in *Strategy Beyond Markets* has grown significantly over the past couple decades. However, despite this growing interest, the importance of the field relative to other areas of strategic management does not align with the views of executives. As illustrated above, executives view *Strategy Beyond Markets* as fundamental, while the community of strategic management scholars views it largely as a niche.

We base this assessment on a simple analysis of scholarly work published in the Strategic Management Journal (SMJ) and of research papers presented at Strategic Management Society conferences (SMS). SMJ is widely regarded as the premier generalist journal in strategic management, and SMS is similarly viewed as the premier generalist conference. We reviewed all published papers in the SMJ (Volumes 33 through 35) and paper presentations at the SMS[6] over a three-year period from 2012 through 2014. For each article or research note published in the SMJ, we read through the abstracts and identified if the article fit within the *Strategy Beyond Markets* field. To be categorized as a *Strategy Beyond Markets* article, the focus of the research had to be on the strategic interaction between a firm and their *Beyond Market* stakeholders, or on the strategies designed to manage these stakeholders. We erred on the side of inclusion. For example, we included papers that addressed who, when, why, or how to interact with *Beyond Market* stakeholders, and papers that analyze the development of capabilities/resources to respond to these types of stakeholders, or papers that included measures of strategic action or firm performance on some relevant dimension (e.g., net cost of action; protests; boycotts, campaign contributions, etc.). We used the same procedure to identify *Strategy Beyond Market* papers presented during the SMS conferences.

We reviewed 276 papers published in SMJ and 1,984 paper presentations at SMS. The results of our simple analysis are compelling. Less than 10% of the papers published in SMJ and 3% of papers presented at SMS were categorized as addressing *Strategy Beyond Markets*. Within the set of SMJ papers, we also determined the theme in which the research fit. Once again, relative to the weight that executives place on policy uncertainty and government regulation, the fact that approximately 2% of the papers fit into *Public Politics* is quite striking. We recognize that there are other excellent journals that publish strategic management scholarship (e.g., Management Science, Organization Science, Academy of Management Journal, etc.) and that our analysis is suggestive but clearly incomplete. That said, an informal preliminary perusal of these other journals (and of papers presented in the BPS division of the Academy of Management Conference) revealed similar information.[7]

One goal of this volume is to create a launch pad for future scholars in this field. From the analysis above, we can't determine the causes of the field's relatively niche status, but we can self-reflect. Paraphrasing Chester Barnard, if we wish to increase the importance of *Strategy Beyond Markets* in the broader field of strategic management, then we need to identify what the field lacks, and the set of factors limiting its advancement.[8] In our opinion, there are several important unanswered questions in the field and several fruitful avenues for research.

First, we currently have limited understanding of the critical attributes for firms to establish a sustainable *Beyond Market* strategy. While there have been excellent studies highlighting the importance of preemption in *Private Politics*, political ties in *Public Politics*, and forum shopping in *Integrated Political Strategy*, it is unclear if these types of factors are sustainable in the context of political or market dynamics. Furthermore, it is unclear whether these factors differ significantly from those identified in the broader competitive strategy literature (e.g., are political resources different fundamentally from market resources; do firms organizing political resources use a fundamentally different logic than firms utilize to organize market resources).

Second, there has been very little (if any) significant research linking firm strategy to both *Beyond Market* outcomes and firm performance. Most research has developed theories and/or empirical analyses that explore the determinants of a firm's strategy beyond markets. Very few studies have shown that a firm's strategy increases policy performance; almost none have demonstrated a link between policy and firm profitability.[9] Third, the topical areas of analysis appear to be limited. Environmental issues and corporate social responsibility dominate *Private Politics* research, heavily regulated firms dominate *Public Politics* studies, and theoretical studies dominate research on *Integrated Political Strategy*. We believe the papers in this volume answer some of these questions and may help launch *Strategy Beyond Markets* into the mainstream of strategic management scholarship.

The founder of the field of nonmarket and integrated strategy, David P. Baron, has contributed an excellent overview of the field in his paper, "Strategy beyond Markets: A Step Back and a Look Forward." Baron has a unique perspective, having been in the field since its inception and having written the seminal textbook and numerous teaching cases, and continuing to be a contributor to understanding the strategy of the firm beyond markets. In this paper, Baron discusses the creation of the field, highlighting the prominence of the political economy approach as compared to the resource-based theory of the firm. He argues in this paper that this political economy approach to self-regulation by firms can inform managers on how to reduce challenges from public and private politics. For scholars, managers, and students, Baron illustrates these points with three very interesting case studies: Uber and public politics; the Rainforest Action Network and Citigroup and private politics; and The Fast Food Campaign and integrated strategy with both public and private politics. This paper provides a very nice perspective on this volume as a whole.

PUBLIC POLITICS ARTICLES

One of the central questions in the literature on foreign direct investment is how to mitigate the threat of government expropriation. Scholars have developed a variety of theories to address this question. Kenneth W. Shotts, in his paper, "Political Risk as a Hold-Up Problem: Implications for Integrated Strategy," encompasses many of these theories in a single, simple, elegant hold-up model of political risk. The model is particularly useful for three purposes. First, its breadth allows a researcher to examine the comparative statics of many different theories in a single model. Second, its simplicity makes the model a useful teaching tool in graduate level courses. Finally, and perhaps most importantly, the model demonstrates that effective management of political risk requires an integrated strategy, consisting not only of public and government relations efforts, but also financial, value chain, and human resources strategies designed to reduce the government's incentives for expropriation. Overall, the paper pushes the frontier on many fronts.

Traditional models of political strategy examine how interest groups target marginal politicians in a pivotal politics, spatial model. However, politicians vary in the effectiveness at pushing policy through the legislature. Craig Volden and Alan E. Wiseman, in their paper "Incorporating Legislative Effectiveness into Nonmarket Strategy: The Case of Financial Services Reform and the Great Recession," develop a new and innovate empirical strategy for identifying exactly who are the politicians who are most effective at advancing a legislative agenda. They develop an empirical method for assigning each legislator a Legislative Effectiveness Score based on the ability of the legislator to move bills through Congress. They then demonstrate how corporations can use these scores in targeting their lobbying, with a vibrant and detailed case study of financial reform legislation before the U.S. Congress during the Great Recession.

In "A Unified Model of Political Risk," Benjamin A. T. Graham, Noel P. Johnston, and Allison F. Kingsley make an important contribution to the literature on expropriation risks of (foreign) investors. Looking at individual risks, the authors argue, scholars often miss important interdependencies. To provide a fuller picture, they construct a unified model that analyzes different types of risk (violence, outright expropriation, capital controls), borne by different groups of investors (direct investors, equity and debt investors, commercial banks) who vary in their capabilities (access to private information, ease of exit, resistance). The authors show how specific risks vary with the distribution of investor types in the economy and with the specific capabilities of these investors. Perhaps surprisingly, for some groups of investors and model parameters, there is safety in small numbers. Bank lending, for example, is less risky when direct investors provide most of the capital.

In "Motivations for Corporate Political Activity," Adam Fremeth, Brian Kelleher Richter, and Brandon Schaufele ask whether a firm's CEO and/or PAC make campaign contributions that are motivated by strategic or agency concerns. Strategic contributions are those that are expected to help the firm meet its objectives. Agency contributions are made without regard for the firm's objective but rather reflect private benefits of contributions for the CEO (or PAC although the latter usually has a mission aligned with firm interests). This is an important question for the *Public Politics* literature because much of the literature finds inconsistent results regarding the efficacy of campaign contributions for improving firm performance. Scholars have conjectured that the lack of a consistent performance link can be attributed to the fundamental principal/agent problem. That is CEOs and/or PACs may have interests that are not aligned with the interests of firm shareholders and make contributions that reflect their private benefits at the expense of their principal's (firm shareholder's) interests. The authors develop an argument and testable hypotheses that strategic and agency contributions occur simultaneously. To test their hypotheses, they construct a unique dataset of nearly 7 million observations where the unit of analysis is a pairing between a S&P 500 firm-linked actor (CEOs and/or PACs) and a political actor in the general election for office in the U.S. Congress. They measure the campaign contributions associated with these pairs over nine election cycles. They find evidence that agency motivations are apparent within PACs' contributions, and that strategy is apparent within CEOs' personal contributions, and that elements of both agency and strategy exist side-by-side within the actors' contributions.

Rui J. P. de Figueiredo, Jr. and Geoff Edwards also address the open question in the Public Politics literature emanating from inconsistent empirical findings about the effect of campaign contributions on public policy outcomes. In their paper "The Market for Legislative Influence over Regulatory Policy" they argue that scholars may be overlooking an important mechanism for campaign contributions to affect policy. Instead of contributions of just buying support for legislation or access to legislators, the firm may strategically allocate campaign funds to gain support from legislators to bring pressure to bear on regulatory agencies. In their study, de Figueiredo and Edwards provide empirical support for extant theoretical arguments that firms influence regulatory policy through indirect pressure from elected officials. Additionally, they extend prior findings by developing arguments and empirical support for when firms are likely to respond strategically to interest group competition. The authors find empirical support for their arguments by analyzing a dataset of campaign contributions by competing interest groups to state level legislators in the context of regulatory policy governing the local telecommunications industry.

PRIVATE POLITICS ARTICLES

In "Corporate Reputational Dynamics, Private Regulation, and Activist Pressure," Jose Miguel Abito, David Besanko, and Daniel Diermeier model the interaction between firms and activists who may adopt either confrontational campaigns or more benign forms of criticism. To try to placate or deflect activists, the firms may attempt to enhance their reputations through self-regulation – the voluntary effort to reduce a negative externality. They find that, while a firm may face decreasing marginal utility from externality reducing activity thus incentivizing a firm to coast on its reputation, an activist can place reputational pressures on a firm that keeps the firm incentivized to continue to self-regulate and build its reputation. Furthermore, they present conditions under which an activist is more likely to rely on confrontation versus criticism and serves as a nice complement to the Dominik Breitinger and Jean-Philippe Bonardi paper discussed below.

In "Self-Regulation and Regulatory Discretion: Why Firms May Be Reluctant to Signal Green," Thomas P. Lyon and John W. Maxwell model the decision to self-regulate, not as a reaction to the potential actions of activists, but to regulatory agencies. They observe that regulators maintain enforcement discretion thus providing incentives to individual firms to self-regulate to reduce the likelihood of fines and other punishments. They find that self-regulation can be a doubled edged sword – helping preempt further regulation on one hand, while causing a ratcheting of expectations among regulators who demand higher levels of compliance from greener firms. Specifically, firms with lower compliance costs could step forward and substantially self-regulate helping reduce the likelihood of future regulation but increasing the risk of being targeted for stringent enforcement should regulation pass.

In "Private Politics Daily: What Makes Firms the Target of Internet/Media Criticism? An Empirical Investigation of Firm, Industry, and Institutional Factors," Breitinger and Bonardi explore what drives activists to criticize a firm through social media and internet posts. Most research to date on the private politics of activists focus on large campaigns such as protests and boycotts. In this paper, the authors leverage a unique dataset to look at a broad range of factors such as industry, country, and firm-specific dimensions that drive activists to criticize on the internet. What they find is that the motivations and targeting behavior of activists in social media forums is very similar to what has been found for larger campaigns. Large, visible firms from countries with strong institutions and high standards of living are the most likely to be targeted. More importantly, they present evidence that criticism through the media may be the first step toward a broader public campaign against a firm.

INTEGRATED POLITICAL STRATEGY ARTICLES

In "Navigating Natural Monopolies: Market Strategy and Nonmarket Challenges in Radio and Television Audience Measurement Markets," Hillary Greene and Dennis A. Yao chronicle the history of the audience measurement industry in the United States and compare it to strategies and outcomes in foreign markets. The market for radio and television audience ratings tends toward monopoly as a result of economies of scale, the value