

# ANALYZING THE NONMARKET ENVIRONMENT OF BUSINESS: THE (ia)<sup>3</sup>-FRAMEWORK

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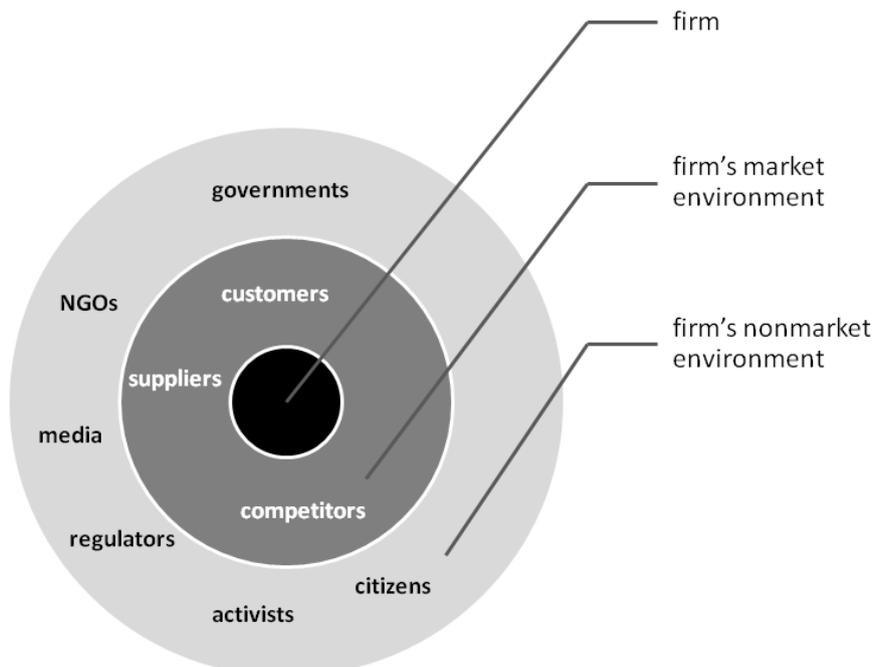
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The environment of business can be divided into the market environment and the nonmarket environment (figure 1). The market environment consists of the set of relationships between a firm and stakeholders that are mediated by markets – principally relationships with customers, suppliers, and competitors. A firm meets its customers in a market and an exchange takes place when the firm offers a product or service at a price equal to or below the value perceived by the customer. An exchange between a firm and its supplier works much the same way, only that now the firm is the customer. And a firm's competitors can be defined simply as other firms trying to satisfy the same customer demand or trying to obtain the same (limited) supplies, including people and capital. In this part of the business environment, the laws of supply and demand, of equilibrium prices and quantities produced, reign supreme.

**FIGURE 1**  
**THE ENVIRONMENT OF BUSINESS**



Surrounding the market environment is the firm's nonmarket environment. Here we find relationships between the firm and other stakeholders that are *not* mediated by markets. The

relationship between a firm and the government is ordinarily hierarchical and characterized by power and authority, rather than by demand and supply. What a firm exchanges with a regulator, an activist group, or the media is generally not economic in nature, and is not governed by the laws of demand and supply. Sometimes, a firm's nonmarket environment can even include interactions with formal competitors, such as when firms work jointly in an industry association, lobby the government together, or try to devise self-regulatory solutions or an industry code of conduct to address a given problem. What matters is that the relationship unfolds outside of markets is not governed by the laws of demand and supply but rather by complex formal and informal rules governing such settings.

## ANALYZING THE MARKET ENVIRONMENT

Formulating an effective market strategy requires a sound analysis of the firm's market environment. The most prominent tool to this effect remains Porter's Five Forces model, which is used to dissect markets (or industries) based on the relative power of buyers and supplier, the existence of entry barriers, the availability of substitutes, and the degree of industry rivalry. A rigorous market analysis helps firms identify the principal challenges it might encounter and to design the necessary strategic response.

## ANALYZING THE NONMARKET ENVIRONMENT

Just as a proper analysis of the firm's market environment is necessary for the formulation and implementation of an effective market strategy, managers must carefully analyze their firm's nonmarket environment if they want to proactively manage it via an effective nonmarket strategy. Markets and nonmarkets differ in several respects and the tools for their analysis consequently differ as well.

Building on earlier work by David Baron<sup>1</sup>, Bach and Allen<sup>2</sup> propose to analyze a firm's nonmarket environment through a sequence of six questions, each of which leads directly to the next:

- What is the **issue**?
- Who are the **actors** that care about this issue?
- What are the various actors' **interests**?
- In which **arena** do the actors meet to settle the issue?
- What **information** moves the issue in this arena?
- What **assets** do the actors need to prevail in this arena?

Because it focuses on issue-actors-interests-arena-information-assets, or i-a-i-a-i-a, the tool is simply called the (ia)<sup>3</sup>-framework.

In order to obtain a complete picture of its market environment, a firm – using Porter's Five Forces or a similar tool – has to separately analyze every industry in which it competes. Likewise, a firm must conduct an (ia)<sup>3</sup> analysis for every nonmarket issue with the potential to affect its bottom line. There may be overlaps for sure from one issue to another. A particular group or organization may be involved in multiple issues affecting a firm, for example. But for analytic clarity, it is useful to keep issues separate.

Let us consider each "i" and "a" in turn:

<sup>1</sup> David P. Baron (1995), "Integrated Strategy: Market and Nonmarket Components," *California Management Review* and David P. Baron (2006), *Business and its Environment* (Upper Saddle River: Pearson).

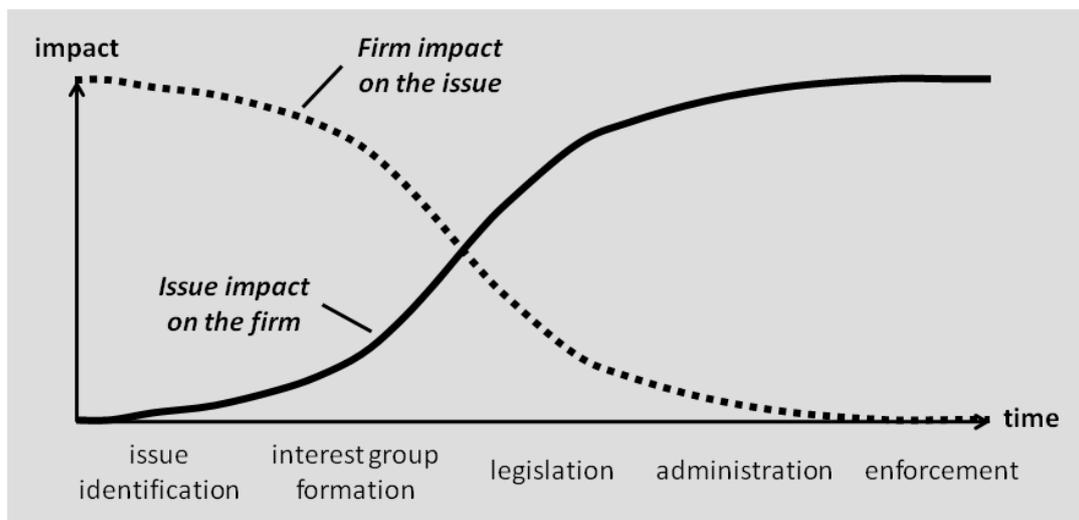
<sup>2</sup> David Bach and David Bruce Allen (2010), "Beyond the Market: What every CEO needs to know about Nonmarket Strategy," *Sloan Management Review*.

## WHAT IS THE ISSUE?

The “issue” is the unit of analysis in the nonmarket environment. The *Oxford English Dictionary* defines “issue” as “a point in controversy on which interested parties take affirmative or negative positions.” The very notion of “issue” thus suggests a certain degree of conflict, of disagreement, among critical actors. If everybody agreed, if there were consensus on the topic in question, it simply would not be an “issue”.

A firm’s nonmarket environment is structure by issues. A firm should take a position on an issue if the issue’s resolution could significantly affect the firm’s ability to create and/or to appropriate value. This applies both to the upside and the downside – it is not just a matter of neutralizing threats but also recognizing issues whose favorable resolution would generate a new business opportunity. The firm’s market strategy – its plan for satisfying customer needs and appropriating a part of the value generated in the process – thus determines the significance of nonmarket issues. Clearly, a debate over the allocation of London Heathrow airport landing slots for transatlantic flights will be important to British Airways, but it will be of little concern to either Ryanair or EasyJet, neither of which compete on transatlantic routes. However, both low-cost providers will be concerned about any proposal to raise landing fees at tertiary European airports because these constitute many of their destinations. A firm cannot worry about every single potential issue. It must carefully focus on the ones with the greatest potential to affect the bottom line. To be strategic means to choose and to focus; this is true for the nonmarket environment as much as for markets.

FIGURE 2  
THE ISSUE LIFE CYCLE



Issues pass through what David Baron calls the “issue life cycle” (figure 2). Once an issue has been identified, interest groups form and take positions on the issue. Some of these interest groups may push for a “resolution” of the issue through legislation or other types of rule-making subsequent to which the rules are administered and enforced. Not all issues pass through the entire issue life cycle. In fact, many issues get “stuck” in the cycle, often somewhere between interest group formation and legislation and sometimes it becomes a firm’s deliberate strategy to prevent an issue from making it to the legislation phase.

Where a particular issue is in the cycle matters profoundly as the impact of the issue on the firm – and the impact of the firm on the issue – vary greatly across stages. During the issue identification phase, the impact of an issue on a firm is close to nil. This is in sharp contrast to the enforcement

phase where the impact is often substantial. Yet crucially, even though the impact of an issue on the firm is often negligible during the identification phase, this is the time when the firm may have maximum impact on the issue and its future evolution. The firm's ability to influence an issue is also still quite substantial during the interest group formation stage as a pro-active firm might shape the views of key stakeholders such as policymakers and the public. As the issue progresses through the life cycle, the firm's ability to radically influence its evolution declines, just as its potential impact on the firm grows.

### **WHO ARE THE ACTORS THAT CARE ABOUT THIS ISSUE?**

In its definition of "issue", the *Oxford English Dictionary* highlights the importance of "interested parties" and the potential conflict among them. So the next important step in the analysis of a firm's nonmarket environment is to identify the actors who care about the issue in question, which are generally those with an economic, political, or ideological stake in the issue. Take again the example of airport landing slots. Besides the various airlines using the airport, one can assume that airport operators, providers of airline services such as catering, fueling, or maintenance, residents living in the vicinity of this airport and perhaps other airports in the region, municipal governments, and environmental groups concerned about air and noise pollution will sufficiently care about the issue to try to influence its outcome.

Not all actors are equally powerful. Money and headcounts are certainly important. That is why many people assume that big business always prevails in politics. But history is full of determined citizen groups or activists prevailing over wealthier opponents. Just think of the way Greenpeace defeated Shell in the battle over the abandoned Brent Spar oilrig, or how a small group of activists held Nike to account over sweatshop labor practices among its overseas suppliers, or how local farmers and community groups in India forced Tata Motors to scrap plans for a state-of-the-art automobile plant in Singur despite strong support for the project from the regional government in West Bengal and national policymakers.

In politics, organization is decisive. Organized groups – such as European farmers demanding agricultural subsidies – are often more powerful than unorganized consumers who have to foot the bill via higher food prices or taxes, even though the latter outnumber the former by more than 50:1. This is why a local community group mobilizing for or against a given issue will always begin by "organizing" – signing up members, networking with like-minded groups, and formulating agreed-upon statements and positions.

### **WHAT ARE THE VARIOUS ACTORS' INTERESTS?**

Once you have identified the range of actors who care about an issue, the next critical question is what these actors actually want. What is their position? What exactly are their goals? What motivates them and what makes them tick? What do they hope to achieve and how critical is this issue to them really? Whose stand on the issue is non-negotiable and who might be open for compromise? Probing the various actors' interests carefully is perhaps the most important step in the analysis of the firm's nonmarket environment. Doing this properly enables managers to draw up a "strategic map" that identifies potential allies and clear adversaries. Since in politics organization is everything, chances of success are much greater if one can put together a coalition of actors. Rarely will policymakers come to the help of one particular company, but if an entire industry is aching – and the leaders of multiple firms have come together around a shared position, ideally even with the support of non-business citizen groups or associations – then all of a sudden a favorable policy change can become feasible.

An additional important dimension is the degree of interest homogeneity among the members of a given collective actor. Managers should ask themselves whether all members of a particular group or association feel the same way about the issue or if there is a degree of heterogeneity – an

internal split – that provides an opening for engagement? The Tobacco Institute, a high-powered lobby group for the US cigarette industry from the 1950s to the late 1990s, was a particularly effective actor not just because of its vast financial resources and organizational capabilities, but because its members' interests on a broad range of issues were very closely aligned. In contrast, the European Roundtable of Industrialists (ERT) represents CEOs from a broad range of industries which increases the chance of interest heterogeneity among its members. When such a diverse group does agree on a common position, however, its influence can be considerable as it represents a broad cross-section of European business.

Generally speaking, the two dimensions – organization and degree of interest homogeneity – explain a great deal of variation in political power across actors (figure 3).

FIGURE 3  
POLITICAL ACTORS AND POLITICAL POWER

|             | Homogenous                      | Heterogeneous                                       |
|-------------|---------------------------------|---|
| Organized   | <b><i>Tobacco Institute</i></b> | <b><i>European Roundtable of Industrialists</i></b> |
| Unorganized | <b><i>Entrepreneurs</i></b>     | <b><i>Consumers</i></b>                             |

(a darker color signifies greater political power)

All else being equal, the more organized a group is, and the more homogenous its members are in terms of interests, the more powerful the group is going to be in politics. The Tobacco Institute was highly organized and its members fully aligned in terms of their interests on all the critical issues affecting the regulation of the industry. In contrast, consumers tend to be wholly unorganized and usually have heterogeneous interests. This makes them ordinarily one of the weakest groups in a political controversy despite always being by far the largest group. Organized actors with generally heterogeneous interests, such as the ERT, and unorganized actors with homogenous interests, such as entrepreneurs (who often share similar interests such access to risk capital and the removal of barriers to starting new businesses, but who are usually not well organized as a group), are somewhere in the middle when it comes to political influence – weaker than organized homogenous actors but stronger than unorganized heterogeneous ones.

### IN WHICH ARENA DO THE ACTORS MEET TO SETTLE THE ISSUE?

Nonmarket issues can play out in multiple settings, from courtrooms and regulatory proceedings to parliamentary committee hearings and industry forums all the way to the news media, the public domain, or the blogosphere. Knowing in which arena actors concerned about an issue must meet to settle the issue matters greatly because the rules of the game vary greatly across setting. For example, members of parliament care about multiple issues and offering support on an issue their constituents consider particularly important can be a good strategy to get a legislator's endorsement for a policy initiative. But this strategy is less likely to sway professional regulators who tend to be more narrowly-focused and generally do not have to worry about winning re-election.

Similarly, arguments that might carry weight in a court of law can be irrelevant or, even worse, backfire dramatically in what is sometimes called the "court of public opinion." Consider the following example. During his 2004 run for the White House, Democratic US Senator John Kerry famously said during an interview "I actually did vote for the \$87 billion before I voted against it."

He was talking about a bill funding US troops in Iraq. What Kerry meant was that he had voted for a bill funding the troops that also contained a provision reducing some of President Bush's tax cuts in order to pay for the troop funding. However, that bill did not get a majority of votes and did not pass. When the tax provision was stripped from the bill by Senate Republicans, Kerry voted against the final bill, even though it passed. So what he said was technically correct and in a court of law or other formal arena, his words might have carried weight. But in the public sphere, on cable news and in the blogosphere, what he said sounded just plain silly. It led to Kerry being brandished a "flip-flopper", a label that he never lost during the campaign and that helped sink his presidential ambitions.

Managers must understand the arena in which an issue plays out and eventually gets settled so that they can develop a strategy accordingly. For example, lobbying the president of a country to lower official interest rates will not be effective if interest rates are set by the central bank and central bankers are fully independent of elected officials. Managers must also understand the formal and informal rules governing a given arena. Managing nonmarket issues across borders presents additional challenges. A firm can try to settle a nonmarket issue with a foreign firm through the dispute resolution process of the International Chamber of Commerce (ICC). But a firm cannot sue another firm through the World Trade Organization (WTO) because only states have standing at the WTO. To apply pressure through the WTO a firm needs to first lobby its own government to take an issue to the WTO so that the WTO can apply pressure on the foreign government which might get the foreign firm to change its behavior. The process in this arena is thus considerably more complicated and resource intensive, though it might be worth it as WTO decisions are binding whereas firms follow ICC decisions merely on a voluntary basis.

Because the arena in which an issue gets settled is so important, clever firms often focus a lot of energy on trying to move an issue to a more favorable arena. For example, when Spain's Endesa was faced with a hostile takeover bid from a local rival and suspected the Spanish government may have played a role encouraging the bid, Endesa's lawyers tried to move jurisdiction for the merger approval process to the European Commission in Brussels rather than leaving it with local Spanish authorities.

Complicating matters, many important issues play out in multiple arenas simultaneously. At the formal international level, the debate over climate change and the need to limit greenhouse gas emissions is led by the UN and occurs through formal gatherings such as the 2009 Copenhagen Summit. But the debate also simultaneously takes place in national parliaments around the world, in industry forums such as the Business Council for Sustainable Development or the Global Compact, and in the news media. A firm wishing to play a leading role on this issue thus needs a comprehensive nonmarket strategy that considers all of these different arenas.

### **WHAT INFORMATION MOVES THE ISSUE IN THIS ARENA?**

If money is the currency of markets, information is the currency of the nonmarket environment. However, there are some important differences between money and information. Money is highly fungible, meaning it can be put to different uses in many different settings. A firm can spend money it has earned in a venture in India on doing R&D in Colombia, for example, or on procuring machinery in Poland. Information, in contrast, is more context specific. Understanding how the parliamentary political process works in India, for instance, will probably not help the firm navigate the patent system in Colombia or deal with new employment regulation in Poland. In short, the kind of information that can influence the evolution of an issue varies greatly across arenas.

It is clear that the usefulness certain types of information will depend upon the setting. Public opinion data will be more effective in lobbying critical members of a congressional or parliamentary committee concerned about reelection, for example, than in a courtroom or a formal regulatory hearing.

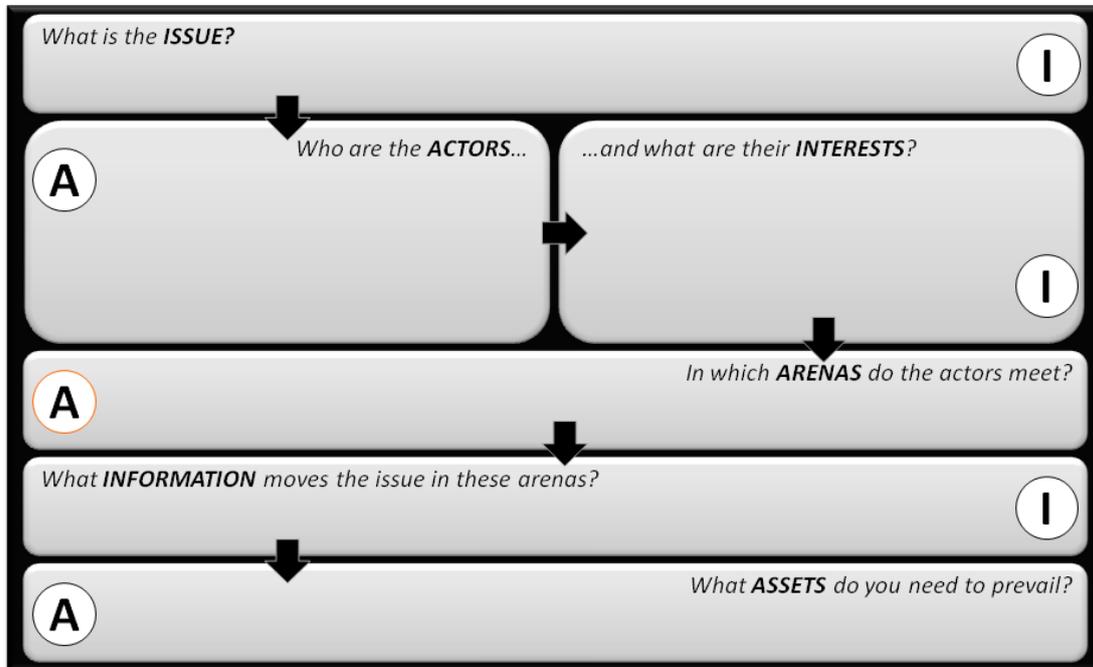
Owners of critical information often have a decisive advantage in the nonmarket environment. One reason why US pharmaceutical firms were so influential in shaping the intellectual property-related agenda for US trade negotiations in the 1990s is because they could provide policymakers with hard-to-get information about the alleged losses to foreign piracy US firms suffered. In contrast, opponents had a hard time showing how stricter patent rules might impact the availability of drugs in developing countries. In many instances, opposing camps will make contradictory claims about the expected effects of a policy. While an association of employers might argue that lower unemployment payments will provide stronger incentives to look for a job and thus boost economic growth, unions might claim that lower payments only depress domestic demand, deepen a recession, and thus further thwart job growth. Since politics – whether in formal or informal settings – is all about persuasion, having the right kind of information for the issue and arena in question, and packaging it in the right way, is critical for success.

### **WHAT ASSETS DO THE ACTORS NEED TO PREVAIL IN THIS ARENA?**

Lastly, while having the right kind of information for a given issue and arena is critical, other assets matter as well. A firm's reputation and its perceived trustworthiness are essential if it wants to influence an issue in the public domain. Detailed knowledge of a committee's decision-making procedures or key members' concerns and policy positions are often necessary to influence an issue in the context of a parliamentary committee. For reasons described above, a broad network of contacts and the ability to quickly assemble and mobilize coalitions are usually critical assets. However, association with the wrong actors – a disgraced former dictator, for example, or a controversial policy group – can be a major nonmarket liability. Not just policymakers but also nongovernmental organizations and a broad range of other important actors may refuse to work with a firm that has a major reputational problem because of its prior conduct and/or associations. Neither a strong reputation nor a broad network of potential allies and partners can be built overnight. Just like critical market assets, such as a strong brand, a stock of proprietary intellectual property, or highly motivated employees, the firm must strategically develop nonmarket assets over time. The same is of course true for in-house capabilities to manage nonmarket challenges, which range from skilled experts in government affairs and public relations all the way to top management involvement and a general and broadly diffused sensitivity to the importance of nonmarket issues. What role does money play in all of this? Clearly, money can be an important nonmarket asset. Money enables a firm to dedicate senior staff to nonmarket issues, to build partnerships, to invest in reputation-enhancing initiatives, and to retain the services of outside experts if needed. But paradoxically, money can sometimes be a nonmarket liability. Many companies get targeted by activist groups precisely because they are seen as rich and powerful. The media loves nothing more than a David vs. Goliath plot featuring a group of passionate, resource-poor local activists taking on a giant multinational. In some instances, it is simply not clear if money is an asset or a liability. In the wake of the subprime mortgage crisis, US investment banks literally poured tens of millions of dollars into lobbying against the sweeping re-regulation of their industry. But the fact that these firms had returned to making billions of profits even before fully re-paying taxpayer cash infusions received during the height of the crisis was precisely why there was so much public pressure on policymakers to rein the banks in.

Figure 4 captures the analytic journey through issues, actors, interests, arenas, information and assets.

FIGURE 4  
THE (IA)<sup>3</sup> ANALYTIC JOURNEY



A rigorous and ongoing industry analysis is essential for success in the market, but it does not guarantee it. Likewise, performing an (ia)<sup>3</sup> analysis for a critical nonmarket issue alone does deliver a nonmarket edge. However, a careful and deliberate analysis of the nonmarket environment sets the stage for proactive as opposed to reactive nonmarket management. By drawing up a strategic map – identifying who cares about an issue, what the various actors' interests are, and in what arena(s) they meet and the issue gets settled – a firm can plot what information and assets it may need to shape the issue's evolution in a way that favors its business interests. ■ ■ ■