

# Chapter 1

## Market and Nonmarket Environments

The objectives of this chapter are to introduce the concept of the nonmarket environment, provide frameworks for characterizing that environment, and present a framework for understanding the development of nonmarket issues. The nonmarket environment is characterized by the four Is: issues, interests, institutions, and information. This characterization is illustrated in some detail for the automobile industry. The emphasis of the approach maintained throughout the book is on nonmarket strategy; i.e., actions by managers to improve the performance of their firms in both their market and nonmarket environments.

The field of business and its environment focuses on the nonmarket environment of business and its interrelationships with the market environment. To illustrate the perspective presented in Figure 1-1, an example involving Pizza Hut is presented below. The basic unit of analysis is a nonmarket issue, and in the Pizza Hut example the issue is how to open the institutional (hospitals, schools, etc.) market to fresh pizza. The auto industry example in the chapter illustrates the types and range of issues facing an industry.

This chapter also presents a characterization of the pattern of development of a nonmarket issue and discusses the causes of change in the nonmarket environment and how issues are placed on the nonmarket issue agenda. The nonmarket issue life cycle in Figure 1-2 is a useful framework for thinking about where an issue presently is and how it could develop. It is important to emphasize, however, that the focus of the book is how firms and their managers can participate effectively and responsibly in influencing the development of those issues.

A lecture based on Chapter 1 might begin with Figure 1-1 and illustrate the interactions between the market and nonmarket environments using the auto industry as an example. In an introductory lecture it is important to discuss those factors that distinguish the nonmarket environment from the market environment. Issues such as fuel economy standards have clear implications for the design and marketing of autos and for the likely success of U.S. and foreign manufacturers. Environmental issues, such as global warming and emissions of pollutants, can also be used to illustrate these interrelationships. The safety issue can be used to point to the presence of interest and activist groups and their role in the nonmarket environment. (Activists and NGOs are considered in more detail in Chapter 4.) The Pizza Hut example presented below can also be used to illustrate the interrelationships.

In discussing nonmarket issues and the nonmarket environment, it is important to emphasize the role of managers both in addressing the issues and in formulating strategies. That is, management is in the center of Figure 1-1. Specialists, such as lawyers and consultants, can be important resources, but managers ultimately must make the decisions. In part because managers are at the center of decision-making, the appropriate level of analysis is organizational; i.e., from the point of view of a firm dealing with an issue in its environment. The unit of analysis is thus the conjunction of a nonmarket issue and the firm.

The roles of institutions and interest groups should also be pointed out, although they are not considered in detail until subsequent chapters. It would be useful to emphasize that institutions are not only formal and public, such as Congress and NHTSA, but are also private, such as arbitration mechanisms, or collections of private organizations as in the case of the news media (considered in Chapter 3). The Pizza Hut example can be used to illustrate the role of institutions and how an issue can move from one institutional arena to another.

The chapter first characterizes the nonmarket environment in terms of the 4 Is. *The Nonmarket Environment of McDonald's* case provides an opportunity to consider this characterization. Another possibility is to discuss the origins of nonmarket issues such as those for the auto industry or those on McDonald's agenda. Some of those issues are the result of scientific discovery and technological change and some are the result of new understandings. For example, the concerns about the fat and salt content of fast foods are a result of both recent medical studies and the heightened concern of many people about their health. The chapter case *The Nonmarket Environment of Google* presents a set of issues that pose challenges for Google including operating in China, a controversial acquisition, and intellectual property protection.

Many nonmarket issues arise because of moral concerns, and those moral concerns are the subject of Part V of the book. The Graduation Cards example illustrates the connection between moral concerns and the development and progress of nonmarket issues. Additional information on the example is presented below.

The nonmarket issue life cycle depicted in Figure 1-2 reflects a progression for many issues. It begins with the origins of the issue and its identification by what are referred to here as interest groups. The auto safety example is a good illustration of the simple origins of an issue and how it may progress over an extended period of time. In the discussion of the cases, it is often useful to assess where an issue is in its issue life cycle. It is also useful to illustrate in which institutional arenas an issue is considered at the various stages in its development. An important point to make in discussing nonmarket issues is that the firm rarely has control over events or the resolution of a nonmarket issue. Instead, a firm has control over its nonmarket strategy, and that strategy may influence the resolution of the issue. Nonmarket issues are generally contested, and their resolution is often determined by a competition of strategies of the interests participating in the contest.

**Beginning the course:** In addition to the cases in Chapter 1, the Chapter 2 cases provide good vehicles for focusing on nonmarket strategy.

### **An Example of the Interactions of Market and Nonmarket Strategies: Pizza Hut**

This example illustrates the use of nonmarket strategies to shape market opportunities (Figure 1-1). (Figure 2-2 illustrates the control of market opportunities by government.)

School cafeterias served nearly \$500 million of pizza a year. Only frozen pizza was used, however, because freshly prepared pizza was effectively excluded by a U.S. Department of Agriculture (USDA) regulation that required inspection of any pizza with meat toppings that was sold at wholesale for resale. The same was true for other institutions such as hospitals and prisons. The

broader issue was the closure of the institutional market to freshly-prepared foods such as pizza and other fast foods.

Pizza Hut's overall business strategy was to become a "pizza distribution" company, and the institutional market was crucial to that strategy. According to Roger Rydell of Pizza Hut, schools were "'a potentially enormous business for us. . . . We'd like to have every one of our [4,000] delivery-capable units nationwide serving at least one school.'"<sup>1</sup> Since Pizza Hut was excluded from the institutional market by the USDA regulation, the task before Pizza Hut was to develop a nonmarket strategy to modify this regulation to allow school cafeterias and ultimately other institutions to order fresh pizza.

There were two basic institutional arenas in which Pizza Hut could address this nonmarket foreclosure of a market. One was the regulatory apparatus of the USDA. From the perspective of a bureaucracy such as the USDA, an exemption from its meat inspection responsibilities would be required. It seems unlikely that the USDA would want to weaken its own inspection program. Indeed, the opponents of an exemption for fresh pizza, as led by the National Frozen Pizza Institute, sought to have the contentious issue resolved by the USDA. A resolution in that institutional arena would necessitate an extensive administrative process requiring public hearings, publication of proposed regulations in the *Federal Register*, a comment period, possible adoption of an exemption, and possible legal challenge in the federal courts by the losing side. This process would likely be quite lengthy. (See Chapter 10 for a discussion of this process.) Pizza Hut first attempted to obtain a USDA exemption without an administrative process but failed in its attempt.

The second institutional arena was Congress, which could enact legislation to overturn regulations. Pizza Hut worked through Congress to include a provision in a 1991 agriculture bill that would allow fresh pizza to be purchased by school cafeterias without USDA inspection. The amendment directed the USDA to issue regulations by August 1992 allowing fresh pizza with meat toppings to be sold to private and public institutions.<sup>2</sup> Pizza Hut had headquarters in Wichita, Kansas, and Representative Dan Glickman, whose district includes Wichita, commented that the USDA regulation was "a Byzantine, outdated and, quite honestly, an anti-competitive regulatory structure."<sup>3</sup>

One question was whether this issue was resolved by interest group politics or by some public policy process based on a careful study of the costs and benefits. The opposition, for example, argued that an exemption posed a health hazard, whereas Pizza Hut argued that precooked toppings such as pepperoni had already undergone two inspections—one at the processing plant and one earlier at the slaughterhouse. These arguments likely had little effect on the decision other than to convince members of Congress that there was no health hazard in fresh pizza sold to institutions. This issue was ultimately resolved through interest group politics, with Pizza Hut and other fast-food chains backing the exemption and frozen pizza interests opposing it.

The actual process through which the amendment was adopted began in the House Committee on Agriculture. The committee was in a public mark-up session on H.R. 3029, sponsored by

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<sup>1</sup> *Wall Street Journal*, November 29, 1991.

<sup>2</sup> *Wall Street Journal*, November 29, 1991.

<sup>3</sup> *San Francisco Chronicle*, November 28, 1991.

Representative De La Garza (D-TX), entitled the Food, Agriculture, Conservation, and Trade Act Amendments of 1991 and the Recreational Hunting Safety and Preservation Act of 1991. Representative Glickman introduced an amendment that would change the standard for fresh pizza with meat toppings furnished in school lunch programs. After discussion, Glickman withdrew the amendment and offered another that would exempt fresh pizza with meat toppings from a final inspection by the USDA and directing the USDA to adopt new rules to allow this. That amendment was approved on a voice vote.

The final bill incorporated the needed provisions in Section 1016 of Title X -- Miscellaneous Technical Corrections. The provisions made changes in Section 23 of the Federal Meat Inspection Act (21 U.S.C. 623) and Section 15 of the Poultry Products Inspection Act (21 U.S.C. 464). As an example of the language enacted, the changes for meat stated, “the Secretary [of Agriculture] shall exempt pizzas containing a meat food product from the inspection requirements of this Act if -- (A) the meat food product components of the pizzas have been prepared, inspected, and passed in a cured or cooked form as ready-to-eat in compliance with the requirements of this Act; and inspected, and passed in a cured or cooked form as ready-to-eat in compliance with the requirements of this Act; and (B) the pizzas are to be served in public or private nonprofit institutions.”

The amendment providing the exemption was referred to as the Pizza Hut amendment.

### **Update on the Graduation Cards Example**

Hallmark’s marketing of the graduation cards featuring alcoholic beverages was quickly met with protests by the Orange County, California, chapter of MADD. According to *Newsweek*, “Since then MADD activists across the country have lobbied store owners to pull offending cards that had been shipped already off their shelves. ... Hallmark spokeswoman Diane Wall says the cards were aimed at adults finishing college. But MADD’s Janet Cater says they were bought just as often for younger high-school and college graduates. ‘The reality is more people graduate under 21 than any other age group,’ Cater says.”

Hallmark quickly agreed to stop producing the cards and not to ship any cards that had already been produced. “Hallmark has made a corporate decision to no longer manufacture graduation cards with reference to alcohol. Graduation cards of this type represented only 1 percent of the graduation card line this year.” (Letter from Diane Wall, Hallmark Cards, August 22, 1988.)

Although this issue was resolved, one consequence of Hallmark’s actions was that interest groups may now begin to monitor its cards for objectionable material. That is, Hallmark’s nonmarket environment could be changed by this episode.

### **Update: Cellphone Radiation Risk**

FCC Chairman Julius Genachowski proposed reviewing radiation standards for cellphones and other electronic devices. Environmental and Health advocacy groups had urged a review, and the CTIA stated that it expected the review to confirm that there was “no reason for concern about the safety of cellphones.”<sup>4</sup>

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<sup>4</sup> *Wall Street Journal*, June 16-17, 2012.