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Why your company may need a chief external officer:

Upgrading external affairs can help align strategy and improve competitive advantage

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CHANGING COMPETITIVE PRESSURES AND THE NEED FOR NONMARKET STRATEGIES

Companies increasingly face concurrent and sometimes coordinated pressures from governmental and civil society stakeholders within the “nonmarket” (political and social) environments in which they operate. In just the past few years, major social and political events such as the Deepwater Horizon oil spill and the implementation of the Affordable Care Act have had profound and lasting impacts on business. In some instances, even the largest and most sophisticated multinational corporations appear to lack a well-designed strategy or structure for addressing these nonmarket pressures. Several recent examples underscore this reality.

In the spring of 2013, the global apparel and textiles industry – and the big box retailers that sell their products – were shaken by tragic fires and accidents at factories in India and Bangladesh. These tragedies resulted in a series of dramatic global actions and reactions from governments, leading apparel producers and retailers, and civil society actors. Companies like Wal-Mart Stores, The Gap, H&M and others were caught flat-footed in their inability to provide coherent responses to criticisms emanating from a range of governmental and civil society stakeholders. Further, the industry itself was split, with primarily European-based firms calling for aggressive, legally binding commitments, while North American firms urged a voluntary approach. In July of 2013, GlaxoSmithKline appeared ill prepared for responding to allegations that its Chinese-based sales and research staff had routinely engaged in widespread bribe paying and other

corrupt activity. That same month, General Motors relieved one of its most tenured executives and nearly a dozen Indian-based staff when Indian government authorities questioned emissions data for its Chevrolet Tavera sport utility vehicle, forcing the company to recall more than 100,000 vehicles and dealing the company a substantial blow to reputation and brand.

Traditionally, most firms have established a legislative/regulatory affairs function to interact with the various branches of government at national and local levels, and a separate office to deal with community relations, philanthropic donations, and increasingly, issues of social responsibility and sustainability, including interactions with nonprofit nongovernmental organizations (NGOs). Emerging issues such as climate change, financial regulation and disclosure, cybercrime and terrorism, and the labor and human rights of workers in developing countries, however, all require proactive nonmarket strategies directed toward both political and social actors. Yet, most companies maintain distinct and separate offices for these functions, potentially leading to uncoordinated and at times conflicting objectives and outcomes.

We believe companies would be well served to recognize the interdependencies between the political and social environments and the actors engaged within them and to integrate – or at least align – these managerial functions. Using case study research, we recommend the elevation of the external affairs function within the corporate hierarchy, perhaps even the creation of a new executive, C-Suite level role – *the chief external officer*. In arguing for this enhanced attention to the nonmarket environment, we show how chief

executive officers (CEOs) and their top management teams can make the most of this new functional competence. Our study shows that by increasing the stature and influence of the external affairs function, firms can achieve more effective and strategic actions and policies, ultimately serving to advance their competitive advantage.

PAST RESEARCH ON NONMARKET ROLES AND THE NEED FOR ALIGNMENT

Since David Baron's seminal article on market and nonmarket strategy, there has been considerable academic research on the importance of managing political and social actors and issues. Bach and Allen emphasize that nonmarket context recognizes that businesses are social and political entities, not just economic agents. These nonmarket roles must consider how managers anticipate, preempt, and respond to actors, influences, and actions emanating from the political and social arenas. A basic premise is that these nonmarket actors affect the strategic direction and market objectives of businesses. Moreover, the rapidly changing political and social environment exerts significant — and in many instances increasing — influence over the economic and business environment. However, research shows that many companies are ill prepared to manage a resurgent state and civil society.

While academic research to date acknowledges that organizations should be viewed not as separate from — but embedded within — the social and political environment in which they operate, it has rarely offered concrete ideas about how firms should change their business strategies and operational structures to account for this reality. Indeed, most scholars and practitioners agree that political and social strategies must be aligned with overall corporate strategy in order to be effective; however, the process of achieving this integration is rarely explored.

We argue that a realistic stance for most companies is a balanced approach to corporate strategy, political activity and social responsibility that emphasizes *alignment* between and among these priorities and the functions that are responsible for them. In some instances alignment may mean close partnerships with governments or other stakeholders as part of core business strategy. In other situations, alignment may take the form of looser collaborations with outside organizations and individuals, involving some coordination with commercial activities that includes ongoing and meaningful communication. In either instance, the relationship between the nonmarket and market strategies should not be ad-hoc, but rather conscious, deliberate and well-coordinated.

We use the term *alignment* to convey the need for managers to place their market and nonmarket strategies in parallel such that they are equally informed and guided by corporate vision, values, and objectives. Put another way, market positioning and industry competition should be synchronized with social engagement and political or regulatory activism. Aligned strategies seek to reconcile the sometimes conflicting external demands that a company encounters and modulate those demands in a way that is appropriate for the firm's geographic and market positions. The goal is to leverage the overall nonmarket strategy such that it is a part of the foundation of competitive advantage.

To understand alignment and the role of the external affairs function, we pursued a multi-track approach and research design.

OUR APPROACH TO ALIGNING NONMARKET AND COMPETITIVE STRATEGY

Building on the work of Baron, Bach and Allen and others, we explored how companies managed their social and political environments. We began with a review of nonmarket research to understand the broad institutional factors that determined how nonmarket strategies helped organizations maintain their competitive strategy, and where they failed to improve overall performance. We then interviewed executives from a range of companies to understand how firms manage this function, and we found that most companies approach political and social issues and pressures from two distinct offices and functions — a legal/regulatory function and a community relations/public affairs function. We observed that these two functions were often entirely separate and poorly coordinated.

In this article, we highlight two of the cases in our sample to illustrate the evolution of two companies' nonmarket strategies and the structures that were established to advance them. In both instances, the subject firms were faced with changing political and social pressures. These pressures underscored the need to better align the political and social dimensions of their nonmarket strategies and to better integrate those strategies into overall competitive positioning. Finally, each case underscores how the magnitude of social and political issues may require managerial attention at the highest levels.

Lufthansa and the Changing Political Landscape in the EU

In the mid-1990s, Thomas Kropp managed Lufthansa's government and regulatory affairs office in Brussels, with a total team of nine people. The airline's "corporate embassy" to the European Union (EU) was one of the first of its kind among European airlines and the most substantial in terms of resource commitment. Its mandate was to monitor and interface with the EU policy-making process as it affected air transport and specifically, Lufthansa Group.

Like other major airlines at the time, Lufthansa was under growing pressure to increase fuel efficiency, reduce emissions, and adopt an overall social responsibility and sustainability strategy. Much of this pressure was being exerted at a European level, as policy authority for air transport shifted from national capitals to EU institutions in Brussels. As a result, airlines' external affairs emphasis also shifted away from bilateral international traffic rights, airport slot allocations and engaging with national legislators toward a more integrated, pan-European approach that transcended narrow, short-term political and social objectives. Lufthansa recognized this necessity well in advance of its industry peers. Further, as the demands placed on the company increasingly emanated from multiple jurisdictions, ranging from the EU to consumer pressure groups, the company shifted its attention to broader issues of customer rights, infrastructure and competition. Structure followed strategy

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