

## **PART I**

# **STRATEGY AND THE NONMARKET ENVIRONMENT**

# 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.

## Cases

### The Nonmarket Environment of the Pharmaceutical Industry

This case is designed for the application of the conceptual frameworks presented in Chapter 1. The four principal frameworks to be applied are the interrelations among the nonmarket and market environments, the four I's, the nonmarket issue life cycle, and the origins of change.

This case illustrates the perspective presented in Figure 1-1. The success of the pharmaceutical industry in its market environment, as evidenced by the rapid increase in expenditures for drugs, led to pressures in its nonmarket environment for change. Much of this was interest group based, as payers, including both those in the private and public sectors, sought to control the impact on their respective bottom lines and budgets. In the nonmarket environment the industry's efforts to revise FDA regulations on advertising to consumers provided an opportunity for firms to promote their products through direct-to-consumer advertising. This proved to be highly successful, and the success in the market environment created a nonmarket issue of restricting DTC advertising. Other interrelationships can also be identified in the discussion.

The four I's are straightforward to identify.

**Issues:** pharmaceutical expenditures, marketing expenditures, price increases (for the elderly), collective buying power (Maine, Florida), drug discounts for the elderly, formulary inclusion, sponsorship of research and asymmetric release of information, OTC switching, drug approval and regulation (U.S. and EU), price reporting and backdoor discounts, managed care, patent protection, deceptive advertising, post-marketing surveillance, prices for AIDS drugs, parallel trade.

**Interests:** pharmaceutical companies—generic and brand name companies, consumers/patients, PhRMA, Families USA, the elderly, Public Citizen, insurers (National Institute for Health Care Management), doctors and the AMA, Prescription Access Litigation Project, pharmacy benefits managers, drug stores, pharmacists (NCPA), managed care providers, trial lawyers.

**Institutions:** state legislatures, Congress, news media, public sentiment, federal courts, NIH, FDA, HHS, Medicare and Medicaid, FTC, Bush administration, Commission of the EU and cognizant agencies, German Medicines Control Agency, South African government, Brazilian government, WTO-TRIPS, Indian patent law.

**Information:** about the causes of increased expenditures--drug price increases and prescriptions per person, regarding the effect of DTC advertising on patient health and quality of life, about research and clinical test results, about appropriate patent protection and incentives to develop new

drugs, about the impact of parallel trade, and more generally about the organization of the health care industry.

Change in the nonmarket environment of the pharmaceutical industry originates from interest groups, such as those identified above, from changing market strategies (e.g., direct-to-consumer advertising), globalization, and from moral concerns. Institutional change is illustrated by the revisions in FDA regulations regarding marketing to consumers, which resulted in the boom in DTC advertising. Technological change in the pharmaceutical industry in recent years has focused on biotechnology, and there has been little opposition to the use of that technology for developing pharmaceuticals. The opponents of biotechnology focus on foods and cloning. Moral concerns originate from the AIDS tragedy and its growth in Africa and elsewhere. In the United States moral concerns, as well as interest group activity, generated pressure for discount drugs for the elderly.

The life cycle can be illustrated using a number of the issues. For example, the current DTC advertising issue began with revised FDA regulations (sought by the pharmaceutical companies). Interest group activity began as critics became concerned about the impact on spending and possible undue influence on doctors to prescribe advertised drugs. The pharmaceutical industry strongly backed DTC advertising, since it increased the number of prescriptions written. In the case the issue is currently in the legislative stage as proposals are being made to regulate DTC advertising.

Patent protection issues are now in the enforcement stage, where enforcement is primarily through the courts and also through the discretion granted to the FDA (see the Chapter 14 case *Patent Games: Plavix*). The issue of OTC switching is in the administrative stage awaiting an FDA decision. Drug discounts for the elderly is in the legislative stage with both Congress and the Bush administration developing plans.

**Teaching the case:** This case focuses on analysis rather than strategy formulation, and the most straightforward way to discuss it is to apply the frameworks with the objective of characterizing the nonmarket environment in detail.

**Additional cases on the pharmaceutical industry:**

The book includes several other cases on the pharmaceutical industry, some of which provide more information on issues in this case.

*Patent Games: Plavix* (Chapter 14)

*Compulsory Licensing, Thailand, and Abbott Laboratories* (Chapter 19)

*Pfizer and Celebrex* (Chapter 10)

*Merck and Vioxx* (Chapter 10)

*Pricing the Norplant System* (Chapter 21)

*Consumer Awareness or Disease Mongering?: GlaxoSmithKline and the Restless Legs Syndrome* (Chapter 21)

*Gilead Sciences (A): The Gilead Access Program for HIV Drugs* (Chapter 21)

*GlaxoSmithKline and AIDS Drug Policy* (Part V Integrative Case)

## The Nonmarket Environment of McDonald's

This case provides a vehicle for discussing the 4 I's and for giving priority to the issues. It also identifies the need for a nonmarket strategy to address the issues on the company's agenda. One thing is clear from the case and from subsequent events—McDonald's is very concerned about its public image and hence is an inviting target for critics and activists. Also, McDonald's has revealed that it is willing to make changes in its market strategy to lessen the criticism. Many of the issues facing McDonald's are initiated by activists, and hence the frameworks of private politics (Chapter 4) are relevant.

The Issues are identified by the headings in the case and will not be listed here. One discussion point is the "level" at which issues should be addressed. For example, a number of broad issues are relevant for McDonald's, but it is specific rather than broad issues that have to be addressed by the company. Three such broad issues are: the health consequences of fast food and food in general, who has responsibility for what one eats, and vegetarianism. McDonald's may want to address the first, but the latter two are better addressed elsewhere. For example, McDonald's basic competence is efficiency in delivering food and convenience that people want. If vegetarianism were to become widespread, McDonald's would efficiently provide vegetarian fare. The responsibility for what one eats is a matter ultimately for the institutions of public sentiment, the courts, and Congress. McDonald's should vigorously defend itself in the courts and support the cheeseburger act, but it should do the latter behind the scenes. The first broad issue involves a set of specific concerns, and such concerns will continue to arise as science increases our understanding of the relation between food and health. Obesity has become a public concern, and McDonald's has taken some measures to address the issue, as considered in the Chapter 14 case *Obesity and McLawsuits*. Health is of wide concern to the public and hence to the news media and new issues will arise. For example, after the writing of this case fast food chains came under government and activist pressure to eliminate trans fats from menu items.

The interests are varied and can be categorized as in the chapter.

Organized: NCBA, trial lawyers, Morgan Spurlock, National Restaurant Association, American Meat Association, United Egg Producers, franchisees in Brazil

Unorganized: consumers, vegetarians, obese people

NGOs: Physicians Committee for Responsible Medicine, CSPI, Competitive Enterprise Institute, Environmental Defense, PETA, Compassion Over Killing, ALF, ELF

McDonald's must address issues in a multitude of institutional arenas. The following list is not intended to be exhaustive.



Legislative: Congress, state legislatures (cheeseburger bills), Americans with Disabilities Act (ADA)

Administrative and regulatory institutions: FDA, DOA, Centers for Disease Control and Prevention, Surgeon General

Judicial: Federal courts (e.g., interpretation of ADA), state courts (obesity lawsuits)

Private regulation: Code of Conduct for Suppliers, antibiotics policy, environmental policy, treatment of food animals

International: courts in Chile and Brazil, green lights programs

Nongovernmental: public sentiment (e.g., pertaining to treatment of food animals), news media (e.g., coverage of the obesity and fast food issue)

Information: Information pertains to scientific evidence about health effects of fast food, obesity, acrylamide, etc., the extent of the public's and customers' concerns about the issues.

One distinction that is often difficult for students is to distinguish between interests and institutions. In the framework presented in Chapter 1 an institution is an arena or forum in which nonmarket strategies are executed. Congress is an institution, and its officeholders should be viewed as part of the institution and not as an interest. The members of Congress may have their self-interest at heart, but they also are attentive to constituents both because of a duty to represent them and because they have reelection interests. They also have institutional roles as members of committees, for example.

A useful teaching exercise is to identify for selected issues, the interests that are active or inactive and the institutional arenas in which the issue will be addressed. For example, for the issue of obesity and fast foods interests include trial lawyers and their clients, food companies, restaurants, and activist NGOs. The institutions are Congress, state governments, federal and state courts, the FDA, public sentiment, and the news media. The life cycle concept can be used to discuss where the issues are in the life cycle, how they might progress, which interests will work to advance or reverse their progress, and the extent to which institutions will determine the progress of the issues. This then naturally leads to a discussion of nonmarket strategy. As developed in Chapter 2, nonmarket strategy should not be considered in isolation from market strategy; i.e., a firm should integrate its market and nonmarket strategies. Strategies also have to be implemented, which is the subject of later chapters.

In this regard, it is interesting to note that many of the issues McDonald's faces and the pressures it encounters are in the realm of private politics as considered in Chapter 4. Self-regulation plays an important role in private politics.

In teaching the case students may be eager to move to strategy formulation. To make the transition from the 4 I's to strategy and action, it is important to point out that the rest of the book is about frameworks for how to formulate effective strategies.

A reality check may be needed if the class seems to be moving toward the conclusion that McDonald's should be doing all of what the activists and NGOs demand. McDonald's customers may not see things the same way the activists do. McDonald's has tried on several occasions to respond to health claims by activists. In 1984 it tried "Lite Mac," in 1991 it introduced the "McLean Burger," and in 2000 it introduced "McSalad Shakers." All were failures.<sup>5</sup> (Offering salads is different because a demand exists for them.) Moving away from its traditional core menu items could also provide opportunities for competitors to cater to its core customers. CEO Jim Skinner stated, "We're certainly selling more chicken, and we're selling more fish, and we're selling more items all across the menu. But hamburgers and French fries ... have been at the core of our menu, and I think will continue to be there for the long term."<sup>6</sup>

The Chapter 14 case *Obesity and McLawsuits* considers the issue of the responsibility, if any, of McDonald's for the obesity problem.

**Teaching the case:**

The class discussion may be organized using the following questions.

1. Identify the 4 I's?
2. For selected issues, identify the relevant interests and institutions.
3. What is McDonald's nonmarket issue agenda? Which issues should have the highest priority?
4. Choosing one or two issues, the focus can then be on where those issues are in their life cycles, what forces are propelling them, and how far they are likely to progress.
5. The next step is to discuss some of the specific issues and then consider strategy formulation.

**Developments and additional information:**

McDonald's settled for \$10 million two lawsuits filed by Hindus and other groups over its labeling of French fries and hash browns as vegetarian when the vegetable oil in which they were cooked contained "essence of beef" for flavoring. Most of the settlement funds went to organizations that deal with concerns raised by consumers.

During floor debate on the cheeseburger bill representatives cited a Gallup poll indicating that 89 percent of those surveyed "oppose the idea of holding fast food companies legally responsible for the diet-related health problems of fast food junkies."

Ben Cohen of the Center for Science in the Public Interest argued, "If Congress really believed in personal responsibility, it would help them make responsible choices by passing legislation that would require fast food chains to post signs showing the calorie count for each item on their menu."<sup>7</sup>

Ken Barun, president of Ronald McDonald House charities, who had seen clips of the movie "Super-size Me," commented, "We are talking about someone who has obviously gone to excess

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<sup>5</sup> *Fortune*, August 9, 2004.

<sup>6</sup> *Wall Street Journal*, February 23, 2005.

<sup>7</sup> The Daily Buzz, [www.foodservice.com](http://www.foodservice.com), March 11, 2004.

and exploited a brand that people will relate to in order to make his movie and capitalize on something that is unrealistic. It should be put in the category of the rest of the shock TV that you see. It's a distortion of reality."<sup>8</sup> The movie was, however, fairly successful.

In January 2003 an epidemiological study by Loreli Mucci of the Harvard School of Public Health and Sweden's Karolinska Institute and other researchers "found that eating foods with high levels of the chemical acrylamide appears not to increase risk for colorectal, bladder, and kidney cancers."<sup>9</sup> The acrylamide issue continued to progress, and some chains changed their cooking methods to reduce the generation of acrylamide.

To deal with the issue of the sustainability of fish supply, McDonald's joined with the Center for Environmental Leadership in Business, a division of Conservation International, to integrate "conservation and sustainable agriculture into our global food supply chain and to work on issues related to sustainability in the fishing industry."<sup>10</sup> McDonald's consulted with The Natural Step on the "impacts of all major business activities on the environment and the community."

Bill Zucker of Burson-Marsteller explained, "The NCBA has been working on this issue for years to get the message out that U.S. beef is the safest in the world. The safeguards are there in the industry and from the USDA and FDA. By getting the facts out to avoid a panic, the Cattlemen were able to help people understand that and avoid misinformation and panic."<sup>11</sup> Walt Riker, a McDonald's spokesperson said, "There is just a tremendous depth of experience and learning and best practices, so when something like this happens we don't have to reinvent the wheel or go into what some people might think is a crisis mode."<sup>12</sup> Meat safety has continued to be an issue, but McDonald's has not been specifically targeted.

The company also announced that it was asking suppliers to reduce the use of antibiotics. "It's a public health concern, so we're putting the word out that we want to buy less antibiotics in our meat."

## **The Nonmarket Environment of Google**

This is a broad case that provides for an assessment of the nonmarket environment of Google. Some of these issues are addressed elsewhere in the book. In particular, the spectrum auction is discussed in Chapter 2, and the human rights in China issue is the subject of the Chapter 16 case *Google in China*.

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<sup>8</sup> The Daily Buzz, [www.foodservice.com](http://www.foodservice.com), February 26, 2004.

<sup>9</sup> The study was published in the *British Journal of Cancer*, January 28, 2004.

<sup>10</sup> McDonald's Social Responsibility Report, May 2, 2003.

<sup>11</sup> O'Dwyer's PR Services Report, February 2004. Mad cow disease had been found in Canada 8 months earlier, and the NCBA had begun their informational campaign at that time. Barson-Marsteller's tracking survey in January 2004 revealed that 90% of those surveyed viewed U.S. beef as safe, up from 87% prior to the discovery of BSE.

<sup>12</sup> *New York Times*, January 1, 2004.

The following table identifies the issues and the corresponding institutions and interests as well as the location of the issues in their life cycles. The fourth I, information, is not listed because it is more difficult to summarize in a few words. For example, on the Internet privacy issue there are a number of privacy activists that push privacy issues, but the information that remains unknown is how concerned the general population of Internet users is about this issue. Information is also uncertain about what the consequences would be if privacy legislation were enacted or regulation promulgated by the FTC.

Several issues are in the realm of private discretion and are labeled in the table as corporate social responsibility. These issues are included here because CSR is an important component of management in the market and nonmarket environments.

<b>Issues</b>	<b>Institutions</b>	<b>Interests</b>	<b>Location in Life Cycle</b>
Privacy	Congress; FTC; public sentiment	Activists, rights advocates, private politics	On hold, pre-legislative stage
DoubleClick	FTC, courts	Privacy activists, competitors	Administrative
EU privacy regulations	EU Commission, data protection offices (regulators)	Privacy advocates; citizens	Enforcement
Spectrum auction	FCC	Competitors	Legislative stage
Google books	Courts	Publishers; competitors	Interest group formation
Google news	Courts (Europe); FTC	Content providers	Enforcement (Europe); legislative (FTC)
Trademarks	Courts	Businesses (Websites)	Enforcement
Data protection	Courts	U.S. government; opponents of child pornography	administration
Google health	Public sentiment	Privacy advocates	Issue identification
Google telephone	Markets	Competitors	[market issue]
YouTube (IP)	Courts	Content providers	Administration
Tolls	FCC; Congress	ISPs	Interest group formation
Discrimination	Courts	Plaintiff	Enforcement
Environmental practices (market)	Public sentiment	[[market participants]]	Corporate social responsibility
Philanthropy	Public sentiment		Corporate social responsibility
Indigenous peoples	Public sentiment		Corporate social

			responsibility
China: human rights	China government; U.S. Congress; public sentiment	Human rights organizations; private politics	Administration
China: Online video	Regulators	Competitors	Administration
China: Music downloads	Regulators	Competitors	Enforcement (or lack there of)
Microsoft and Vista	Courts; DOJ	Microsoft	Enforcement
Microsoft and Yahoo	Congress; courts	Microsoft and other competitors	Interest group formation

On some of the issues Google was a nonmarket innovator. Google, for example, was exploring the limits of intellectual property law—from both sides of the law.

The criticisms of G-mail seem to have had no impact. The following are from the Google Web site [www.gmail.google.com](http://www.gmail.google.com) at the time it was introduced.

### **What is Gmail?**

As part of Google's mission to organize the world's information and make it universally accessible and useful, we're testing an email service called Gmail.

Gmail is a free, search-based webmail service that includes more than 2,000 megabytes (two gigabytes) of storage. The backbone of Gmail is a powerful Google search engine that quickly finds any message an account owner has ever sent or received. That means there's no need to file messages in order to find them again.

When Gmail displays an email, it automatically shows all the replies to that email as well, so users can view a message in the context of a conversation. There are no pop-ups or untargeted banner ads in Gmail, which places relevant text ads and links to related web pages adjacent to email messages.

### **Gmail and privacy**

#### **1. Is Google reading my email?**

No. Google scans the text of Gmail messages in order to filter spam and detect viruses, just as all major webmail services do. Google also uses this scanning technology to deliver targeted text ads and other related information. This is completely automated and involves no humans.

#### **2. Will my Gmail messages appear in Google search results?**

No, the contents of your email will never be included as Google search results.

#### **3. What does Google do with my personal data?**

Google uses this information to provide you a reliable service. Google does not share or reveal email content or personal information with third parties, other than in certain exceptions dictated by the law and common sense. For full details, please refer to the 'When we may disclose your personal information' section of our privacy policy. These exceptions are standard across the industry and are necessary for email providers to assist their users and to meet legal requirements.

#### **4. What does Google do to protect my privacy?**

Google takes several steps to guard the confidentiality of users' information by offering a number of industry-leading protections. For full details, please visit the Protecting your privacy section below.

#### **5. Are there ads in Gmail?**

Yes, but they are small and unobtrusive. They don't fill half your screen and we don't make you read them just to get to your inbox. Ads are never inserted into the body text of either incoming or outgoing Gmail messages and you won't see any pop-ups or untargeted banner ads in Gmail.

Gmail users only see relevant text ads, similar to those on Google search results pages . The matching of ads to content is a completely automated process performed by computers. No humans read your email to target the ads, and no email content or other personally identifiable information is ever provided to advertisers.

Ads are matched using the same technology that powers the Google AdSense program, which already places targeted ads on thousands of sites across the web by quickly analyzing the content of pages and determining which ads are most relevant to them. Here's a [sneak peek](#) of how ads look in Gmail.

### **Quotes on privacy**

#### **Google Mail: Virtue Lies in the In-Box - David Pogue**

New York Times - May 13, 2004

<http://www.nytimes.com/2004/05/13/technology/circuits/13stat.html> (registration required)

"If Gmail creeps you out, just don't sign up. ... That would be a shame, though, because you'd be missing a wonderful thing. Even in its current, early state, available only to a few thousand testers, Gmail appears destined to become one of the most useful Internet services since Google itself.

... The ads are so subtle, so easily ignored, that it's hard to imagine anyone preferring the big, blinking, slow-loading graphic ads that appear every time you check for messages at the Hotmail and Yahoo Mail sites. Even more refreshing, Gmail doesn't turn you into an unpaid billboard for Yahoo or Microsoft (Hotmail's owner) by stamping ads on at the bottom of every outgoing message, no matter how sensitive the topic. ...

The only population likely not to be delighted by Gmail are those still uncomfortable with

those computer-generated ads. Those people are free to ignore or even bad-mouth Gmail, but they shouldn't try to stop Google from offering Gmail to the rest of us. We know a good thing when we see it."

### Discussion questions:

1. For each of the issues Google faces identify the corresponding institutions and interests. For a selected few issues identify the information and uncertainties associated with the issues.
2. Where in their life cycles are the issues?
3. What are the origins of these issues? For example, Tolls and Google Books.
4. Let's select a couple of issues and discuss what might be the outcome. (Two issues might be Tolls and Google Books.)
5. To what extent should Eric Schmidt, Sergey Brin, and Larry Page be involved in the management of these issues? For example, Google's operating policies in China.

### Updates

To improve the efficiency of searches, the company used both cookies and user logs of search requests as well as other online information. This raised concerns among privacy advocates.

Information provided by Yahoo in accord with Chinese law led to the arrest of Wang Xiaoning who had posted pro-democracy literature on the Internet. Wang was sentenced to 10 years in prison. Wang, his wife, and a human rights group filed a lawsuit against Yahoo seeking damages and an injunction against Yahoo to prevent it from providing such information to the Chinese government. Yahoo eventually apologized for its actions. In November 2007 Yahoo settled for an undisclosed sum a lawsuit brought by two Chinese journalists who were jailed after Yahoo turned over to the Chinese government emails containing pro-democracy literature. Yahoo said it was complying with Chinese law.<sup>13 14</sup>

Google had been sharply criticized for following Chinese policies regarding policing of the Internet and had take steps to avoid placing its users in jeopardy.<sup>15</sup> Within a month of offering Google.cn, Google came under criticism from two government-run newspapers in China. The *Beijing News* criticized the company for not doing enough to block "harmful information." Referring to Google's practice of informing users when search results had been censored, the *China Business Times* wrote in an editorial, "Is it necessary for an enterprise that is operating within the borders of China to constantly tell your customers you are following domestic law?" Both publications claimed that Google was operating as an Internet content provider without a proper license.<sup>16</sup>

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<sup>13</sup> cnnmoney.com, November 13, 2007.

<sup>14</sup> Google had been criticized when its social networking website Orkut gave a person's IP address to Indian police who were investigating the person for a posting on the website. The person was convicted and jailed. (*Daily Mail*, December 1, 2007.)

<sup>15</sup> See the Chapter 16 case *Google in China* for more information about the criticism and Google's policies.

<sup>16</sup> *Washington Post*, February 22, 2006. Google shared a license with a Chinese company Ganji.com. This practice was common among foreign Internet firms.

In 2006 Google sold its stake in Baidu.

In 2008 the California Supreme Court agreed to hear the Google's appeal of the Court of Appeals decision to allow Brian Reid's age discrimination case to go to trial.

In 2008 Google India Private Ltd. was sued by a small business for defamation because of a posting on an anonymous blog made available by Google. The question was whether Indian law held a website responsible for postings on its service unless it could demonstrate that it had exercised due diligence. This appears to be in contrast to U.S. law as discussed in Chapter 2 and in Chapter 14.

Prosecutors in Italy filed charges against four Google executives of the Italian-language website for the posting of a video showing a disabled girl being taunted by her peers. The charges were defamation and violation of privacy. This case may involve a conflict between EU law and Italian law. According to Google EU law appeared to be similar to that in the United States, as discussed in Chapter 2, in that a website was not responsible for what others post on it.

Google pressed on with its plans to put health data on the Internet, beginning with a pilot project with the Cleveland Clinic. The project would not allow any sharing of information without prior consent.

Google lost its appeal of the Belgian court's decision.

Google settled for \$125 million two lawsuits brought by publishers over its plans to digitize and provide short excerpts on the Internet. The funds will be used to establish a registry system to allow copyright holders to obtain payments.



## Chapter 2

# Integrated Strategy

The principal objectives of this chapter are to introduce the concept of an integrated market and nonmarket strategy, introduce the concept of positioning, and provide a framework for the analysis of nonmarket issues and the formulation of nonmarket strategies. The chapter also reinforces the point made in Chapter 1 that managers are responsible for the formulation and implementation of nonmarket strategies. This chapter extends that perspective by focusing on the integration of those strategies with market strategies, as illustrated in Figure 2-1. One natural focal point for this integration is the relationship between market opportunities and the importance of nonmarket strategies, as illustrated in Figure 2-2. The influence of private politics illustrated in Figure 2-3 is considered in more depth in Chapter 4.

The principal factor restricting the pursuit of market opportunities is government policies. Two other factors are public sentiment and ethics. A lecture might begin with Figure 2-2 and then relate that to the concept of an integrated strategy. The Pizza Hut example in Chapter 1 of this manual can be used to illustrate Figure 2-2 and the nature of a nonmarket strategy to unlock a market opportunity.

The section on positioning provides a foundation for nonmarket strategy, but as importantly it affects the set of issues the firm faces. Some of those issues are identified by government as considered in Part II of the book and others by the news media as considered in Chapter 3, and some are initiated by activists as considered in Chapter 4.

The framework presented in Figure 2-4 provides a framework for addressing nonmarket issues. This framework will be elaborated on in the following chapters, so at this point in the development it is primarily used to identify the stages in the framework. The stages are intended both to correspond to managerial decision-making processes and to distinguish between analysis, or thinking ahead, and deciding. The latter involves choosing a strategy to deal with an issue or a developing policy to guide managers in dealing with issues. Another way of thinking about the stages is that the analysis stage is positive in the sense of prediction and explanation, whereas the choice stage is normative in two senses. The first is that of choosing the alternative that is best in terms of the firm's objectives. The second is normative in the sense of ethics principles. For example, the evaluation of claimed rights requires the application of applying ethics principles. The Citibank and Credit Cards for Undergraduates example illustrates the application of the framework.

It is important that students understand that the perspective taken to the issues addressed in the book is not that of public policy chosen by a benevolent government. Also, the perspective is not that of doing good, or what might be called private social welfare. Instead, the perspective is that of a firm and its managers attempting to further the interests of the firm. No attempt is made to define the firm's interest, but in the first several parts of the book those interests are assumed primarily to be profits. This is tempered by normative considerations based on ethics principles.

Part V of the book addresses issues of corporate social responsibility and the incorporation of ethics into this perspective. See, for example, the Levi Strauss example in Chapter 23.

The final part of a lecture could be on how to approach issues in the nonmarket environment. The framework presented in Figure 2-4 provides an approach to analysis and decision making in which positive analysis precedes the application of normative principles. The distinction between positive and normative approaches can be made at this point. Some students may be concerned that a normative focus — either in the sense of doing good or of applying ethical principles -- should be the centerpiece of any managerial process. As will be clear in Part V of the book, there is considerable support for doing good and also about who has which rights, but there is often considerable disagreement when the focus is specific issues or implementation details. The framework in Figure 2-4 is intended not only to provide an outline for the development of strategies but also to focus on analysis that a manager can use regardless of his or her normative beliefs. That is, even those who might disagree about what is right or good can analyze an issue and attempt to predict behavior and consequences. At this point in the book the objective is for students to be sensitive to issues with normative dimensions and to the actions those dimensions can motivate in the nonmarket environment.

The chapter includes a discussion of a Google's integrated strategy directed at opening opportunities for its products. In 2008 Google petitioned the FCC to prevent Verizon Wireless from excluding a G-phone and other devices.

Google pressed forward on its campaign to obtain access to the white spaces.

## **Cases**

### **Facebook in China?**

The Chinese government had shut Facebook out of the rapidly growing and enormous local market, and this had allowed Chinese companies to enter in virtually all segments of the social media market. Renren.com had successfully occupied the social networking space in which Facebook would naturally operate. Facebook faced the challenge of developing a strategy for the Chinese market, and three basic alternatives were available to it. First, it could enter on its own as Google had done. Second, it could partner with a Chinese company, either a social media company, a search company such as Baidu, or perhaps a mobile communications company. Third, it could stay out of China, in which case interested users would have to devise their own methods of accessing Facebook. The broader strategy challenge for Facebook was how to expand globally by setting up operations in countries or simply making Facebook available to users on its U.S. Web site.

The opportunity for Facebook stems from leveraging from its existing platform and user base and from its caché. If it were to lose the latter, entry in any form might have limited success.

The nonmarket issues that Facebook would encounter if it entered the Chinese market include the following:

- censorship required by the government
- possible requests for personal information of users of its Web site. Facebook required people to register with their real names, and the company would have to continue to do so under Chinese law (China requires Chinese citizens who use the domestic equivalence of Facebook and Twitter to use their real names. Google notified users, “Please note that in mainland China, searching for the character ‘[xxx]’ might cause the link between the user and Google to be temporarily cut off. The cutoff is not in Google’s control.” (L. Gordon Crovitz, “Google Fights Back in China,” *Wall Street Journal*, June 11, 2012.) )
- regulation—particularly if it partnered with a Chinese mobile communications company
- social unrest—Facebook could serve as a communication platform for protesters, as it had during the Arab awakening. The Never Forget June Fourth movement was an example of how Facebook would be used.
- developing relationships of trust
- private politics (Chapter 4) challenges in China and Asia
- public and private politics pressure in the United States. This is evident from the *Washington Post* editorial and from the letter from Human Rights Watch. Moreover, Congress took an interest in Facebook and in the online privacy issue

The issues facing a social media and networking company operating in China are complex and subtle and hence difficult for a Western company to address. Taking a Chinese partner seems to be the best alternative, and large companies such as Baidu are potential partners with complementary lines of business; search in the case of Baidu. The local partner would presumably be responsible for dealing with censorship and with the government. (When it entered the Chinese market Google irritated the government, and relations were strained thereafter. See the Chapter 16 case *Google in China* and the Chapter 24 case *Google Out of China*.)

Any Chinese partner, however, will operate in full compliance with Chinese law and hence will practice self-censorship and will turn over information on users what required to do so by the government. This will generate additional nonmarket pressure in the United States and other Western countries.

A variant of the strategy alternative of entering the market without a local partner would be to operate from Hong Kong as Google has done. The problem with this alternative is that Facebook’s success could be severely limited by remaining an outsider. For example, when Google moved its Chinese search business from the mainland to Hong Kong, it quickly began to lose market share.

The following questions can be used to lead the discussion of the case.

1. How attractive is the Chinese market to Facebook? How well entrenched are the Chinese social media companies?
2. What market and nonmarket challenges would it face if it entered China?
3. What could a Chinese partner do for Facebook that it could not do for itself?
4. Should Facebook be nervous about allowing its partner to manage relations with the government and to practice self-censorship? Should Facebook insist on a privacy policy for users? What would that policy include?

5. What pressures would Facebook face in the United States if it entered the Chinese market with or without a partner?
6. What global strategy should Facebook adopt to deal with government restrictions on its services?

The Chapter 20 case *Facebook and Online Privacy* addresses the user privacy issue in the United States and in other countries.

**Update:** As of mid-2012 Facebook had taken no action with respect to entering the Chinese market nor had it partnered with a Chinese company. Domestic companies continued to solidify their position in the Chinese market.

Facebook went public in 2012 in an IPO that valued the company at nearly \$100 billion. Its share price quickly fell by 20 percent as a result of concerns about its ability to monetize its membership and about nonmarket issues that could lead to regulation that would constrain its use of information.

### **Personal Watercraft aka Jet Skis**

This case is a vehicle for taking the step from the characterization of the nonmarket environment given in Chapter 1 to the formulation of a nonmarket strategy and its integration with a market strategy. Jet skis are a major product success of the 1990s with sales of over \$1.2 billion in 1996 and one million units in operation. This success generated a number of nonmarket issues contested by a range of interests in the context of public institutions. The jet ski industry addressed these issues both through market and nonmarket strategies.

In the context of Figure 1-1, the market success of jet skis generated nonmarket issues that were addressed in public institutions. These issues and their resolution then affected the market environment and the market strategies of the manufacturers. The issues are: safety, emissions into the air, discharges into the water, MTBE, noise, disturbance of wildlife, usage fees, and mandatory instruction and licensing.

These issues are addressed in the institutional arenas of the NTSB and the Coast Guard (safety); EPA (emissions into the air (a CAFE system) and water pollution); National Park Service (emissions, discharges, MTBE, noise, and disturbing wildlife); state environmental agencies—California Air Resources Board/Maine Natural Resources Division (noise, emissions, discharges, MTBE); state legislatures (safety, instructions and licensing); regional authorities—Tahoe Regional Planning Agency (water pollution); and municipal governments—Evanston, Illinois (usage fees). These institutions have the authority to regulate and even ban jet skis from lakes and other waterways. For example, in California concerns about MTBE in drinking water led some local reservoirs to ban jet skis to reduce the MTBE pollution.

The interests involved include jet ski manufacturers, who are organized as the PWIA and also participate in the National Marine Manufacturers Association (NMMA). Jet skiers are also organized for nonmarket action; e.g., the Northern California Marine Association and the International Jet Sports Boating Association. The PWIA and the individual manufacturers provide tracking of the nonmarket issues and encourage and facilitate grassroots action on the issue. Also involved are boat manufacturers and boat users, as considered in more detail below. A large number of environmental organizations and conservation groups were concerned with pollution and wildlife habitat issues. In addition, other users of waterways such as canoeists opposed the intrusion and noise of jet skis. Activists such as the Earth Island Institute and the Bluewater Network also were interested in jet skis and the issues they generated.

Information about the nonmarket issues was reasonably complete and did not play a substantial role in the nonmarket competition on the issues in institutional arenas.

The origins of issues can also be identified. Many of the issues were the result of technological developments such as the powerful jet ski engines that contribute to the market success of jet skis, the noise and air and water pollution they generate, and the hazards they pose to their operators and passengers and to other users of waterways. Some issues such as MTBE contamination from gasoline spills and discharges were the result of institutional change such as the federal government action requiring oxygenates in gasoline. The improvement in scientific instrumentation allows the detection of minute generated not by new understandings but by fears, as in the case of alleged health risks associated with MTBE. There is no evidence that MTBE represents a health hazard.

The issues can also be placed in the stage of their nonmarket life cycles using the pattern identified in Figure 1-2. Most of the issues are either at the legislative or the administrative stages, with government institutions evaluating alternative measures to address the issues. The nonmarket issue life cycle does not predict or explain whether or when an issue passes from one stage to another or ceases to be a contended issue. Prediction and explanation require theories about the effectiveness of strategies. Those theories are developed in Parts II and III of the book.

### **Nonmarket and Integrated Strategy**

The strategies of the interests seeking to restrict the use of jet skis and to force changes in their design; e.g., requiring four-stroke rather than two-stroke engines, are clear. They involve grassroots actions, lobbying by organized interest groups, and the use of the media to call attention to the issues.

The strategy of the jet ski companies is multifaceted. In the context of Figure 2-1 management must bring together market and nonmarket analysis and strategies in the form of an integrated strategy. In the context of Figure 2-2, the jet ski industry and the use of jet skis are relatively unregulated, although some environmental regulations are in place. The threat to the jet ski industry is that the control of market opportunities by government will be substituted for market control. The chief motivation for the opponents of jet skis is the externalities they generate, as considered in more detail in Chapter 12.

The jet ski industry has generally caught the issues at the issue identification and interest group formation stages of their nonmarket life cycles, so the industry has an opportunity to affect the development of many of the issues and to adapt to developments on others. For example, on the safety issue the industry has pushed its model legislation in state legislatures to pre-empt more stringent legislation backed by safety advocates.

The greatest nonmarket asset of the jet ski industry is the number of jet skiers and the boaters who are concerned by the spill-over of more stringent regulations to boats. The users are organized for nonmarket action and the PWIA and the jet ski companies work to facilitate their action. They have had some success, as indicated in the case. The PWIA and the companies track the legislative and regulatory activity on the issues and issue alerts to users on pending action.

Jet skiers are the principal nonmarket asset of the industry, but a potentially more important, but tenuous, asset is the large number of powerboat users. (In Chapter 7 the concept of a rent chain is introduced to identify the source of this asset.) The jet ski companies have consistently argued that jet skis should not be singled out for new regulations; i.e., jet skis and powerboats should be treated the same. The purpose of this position is that makes allies of the powerboat companies and boaters in the opposition to new restrictions. This alliance is tenuous, however, because the powerboat companies recognize that they might be able to escape some new restrictions if they could separate themselves from the jet ski companies. Indeed, it is the jet ski companies that have caused some of the problems such as disturbances to wildlife habitats and increased noise pollution. As discussed in Chapter 8 Genstar, the largest independent producer of powerboats, withdrew from the NMMA because the association was working on behalf of jet ski companies, which Genstar maintained would in the longer run work against the interests of powerboat companies and users.

In addition to its strategy of bundling its interests with those of powerboat interests and mobilizing jet skiers to oppose new restrictions, the industry worked to develop other allies. Its strategy of lending jet skis to law enforcement and search and rescue groups could be important in demonstrating the importance of jet skis and of their use beyond recreational activities. This strategy worked for the snowmobile industry and may work for jet skis as well.

An additional component of companies' nonmarket strategies is to provide information on the safe use of jet skis. The companies include instructions and a videotape with each purchase, and their web sites provide instructions and information on safety, including self-tests of one's understanding of proper jet ski use.

These nonmarket strategies have been and can continue to limit the imposition of new restrictions, but they do not address the sources of the issues. For that, market strategies are required.

Both market and nonmarket strategies must be evaluated for their effect on their corresponding environment and their effect on the other environment as identified in Figure 1-1. Just as nonmarket strategies can avoid some restrictions on the use of jet skis and hence improve market opportunities, market strategies can be used to relieve pressure in the nonmarket environment for additional restrictions. Market strategies include steps to reduce noise pollution by employing new technologies and materials and meeting clean water standards earlier than required by the

regulations. As indicated above, the companies provided information to users about safety and about not disturbing wildlife habitats.

The issue of four-stroke versus two-stroke engines is a difficult one and one that the jet ski manufacturers may well lose. Four-stroke engines substantially reduce discharges into the water, and may be required eventually to meet clean water standards. Even if not needed to meet those standards, they could be mandated by a regulatory agency or a state legislature.

### **Teaching the case:**

The class discussion can be organized around the following questions:

1. What are the issues, interests, and institutions in the nonmarket environment of the jet ski industry?
2. Where are these issues in their life cycle and where did the jet ski companies catch the issues?
3. What is likely to determine the progress, or failure, of these issues in their life cycles?
4. What nonmarket strategy should a jet ski company adopt?
5. What market strategy should a jet ski company adopt?
6. How should those strategies be evaluated; i.e., how should the return from a strategy be evaluated?
7. How should they be integrated?

### **Developments:**

Regulatory and legislative activity continued at the state level and was likely to continue for some time. These actions were likely to diminish the demand for jet skis compared to the absence of the new restrictions. For example, California passed a new law that raised the minimum age for operating a jet ski from 12 to 16 and prohibited jet skiers from jumping wakes within 10 feet of a boat or from spraying bystanders. A federal court upheld the ban of two-stroke engines on Lake Tahoe.

California also proposed new rules that would impose more stringent pollution standards than required by EPA regulations. (California is allowed to have more stringent standards than federal standards.) The proposed regulations to go into effect in 2008 would reduce emissions by more than 65% from EPA allowed levels. The Air Resources Board stated that a jet ski produces as much pollution in seven hours of use as a 1998 automobile driven 100,000 miles. The Board argued that sales of new jet skis and boats would not decrease as a result of the new regulations and estimated that the price of engines would increase by only 14% or by from \$150 to \$2,300. A spokesperson for Californians United to Save Boating said the cost would be much higher and that the regulations would substantially harm the boating industry in California. The spokesperson predicted that as a result of more stringent regulations boaters would hold on to their old high-pollution boats and jet skis longer.

A spokesperson for Brunswick's Mercury Marine division characterized the situation in California as follows: "What we're talking about in California is double and triple jeopardy. We are being attacked from all sides."<sup>17</sup>

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<sup>17</sup> Chicago Tribune, November 7, 1998.

Jet skis were banned from most national parks and recreation areas, and in 2001 a court settlement banned jet skis in all the remaining parks and recreational areas. The lawsuit had been brought by the Bluewater Network, an environmental group, against the National Park Service. The settlement was supported by the Bush administration. Jet skis would be allowed if the Park Service were able to show on a case-by-case basis that the jet skis would not cause harm. A lawsuit filed by a PWC enthusiast, the American Watercraft Association, and the PWIA sought to block the ban from taking effect. In addition, PWC enthusiasts and the industry were working with Republicans in Congress to delay the ban for two years.<sup>18</sup> Both the lawsuit and the congressional activity were underway in mid-2002.

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<sup>18</sup> *The New York Times*, April 15, 2002.



## Chapter 3

### The News Media and Nonmarket Issues

This chapter considers the role of the news media in the life cycle of a nonmarket issue. It is intended to sensitize students to the types of issues the news media brings to the attention of activists, politicians, and the public and to provide a framework for understanding when the media will cover an issue and how the issue will be treated. The media does not create nonmarket issues, but it can accelerate their development and broaden the set of actors who take an interest in them. Media coverage can also make it more difficult for management to address the issue if the firm's actions are under close and continuing scrutiny. Furthermore, as the Alar example illustrates, the news media can intentionally or inadvertently play a role in the nonmarket strategy of an interest group. Because of the importance of the news media in the nonmarket environment, managers need to understand the objectives of the news media and journalists and how to interact with them in an effective manner. From time to time, a dispute between a firm and the news media develops, and managers need to understand the possible avenues of recourse.

From the perspective of nonmarket issues and their development, the objective is to be able to predict which issues involving a firm are likely to be covered by the news media, and for those that are likely to be covered, how they will be treated. As the Alar example illustrates, the media can substantially expand an issue, particularly if it is acting in its role as a “protector of the right of the public to know.” On some issues, the media can also act as an advocate for a particular group or for a particular resolution of an issue.

Social media has joined the traditional news media (newspapers, TV, radio, magazines, etc. where professionalism is present) as a major source of information to individuals and more broadly to the public. The social media can transmit news, opinions, and rumors about companies widely and instantaneously, and many companies make it a policy to respond on their own blogs. The social media writers are dispersed and diversified, which makes certain types of responses difficult if not impossible. Procter & Gamble was able to have a targeted response to the Folger's campaign, but that would have been much more difficult to address if the campaign had been implemented through the social media.

The news media has a difficult job obtaining information often under considerable time pressure. A lecture could address the difficulty of this task. A lecture can also emphasize the broad set of roles of the news media in society and its important role in a democracy.

Predicting coverage and treatment requires a theory, and the chapter presents a simple theory based on two explanatory variables—intrinsic audience interest and societal significance. The theory can be illustrated through examples from the previous chapters. On many issues, reporters seek interviews for balance, controversy, or to have both sides of an issue telling their story. In such cases, the story may already be “in the can,” as indicated in the following episode. John E. Swearingen, chairman of Amoco, Inc. (now part of BP), described his interview with a major television network on the issue of natural gas price regulation: “That interview lasted for about an

hour and forty minutes. . . . she was working from a prepared script, hoping to goad me into giving her a few outrageous answers that would fit into that script. The show, in other words, was already in the can. . . . What is required for television is the quick, easy answer, the scene that stirs people up, the emotional hook which will cause the ratings to jump. And, I suppose, from the point of view of the television producer, there could be nothing more deadly in the vicious ratings game than a long discussion of the facts and figures of an extremely complicated economic program.”<sup>19</sup> This statement illustrates that television seeks short, easy to understand, and visual messages and that complexity and detail are difficult for it to handle. It also suggests that a substantial component of the business community is suspicious of the news media and views it as hostile. See also *General Motors Like a Rock? (B)*.

One issue for discussion is whether the news media is biased or just sufficiently inaccurate that its stories (particularly in the case of television) appear biased to those who are knowledgeable about the subject. The incidents of fabrication, at least those that are detected, are sufficiently common to call into question the review processes of the news media. The incidents also indicate the strong desire among some journalists to have their work published or broadcast. The incidents also indicate that journalism ethics and the law are not sufficient to prevent serious violations of standards.

The news media are in a competitive market, and competitive pressures, career concerns, and profit incentives can affect the behavior of journalists and the news company. A particularly incendiary case is described in *The News of the World* chapter case, which involved unethical and illegal activities by journalists and likely condoned by the executives at the newspaper.

The *General Motors Like a Rock? (A)* chapter case and the *General Motors Like A Rock? (B)* case in this manual deal with a faked media story and a courageous, and ultimately successful, strategy of GM for managing its aftermath. The revelations of faked stories have become sufficiently common that suspicions about news coverage linger. Shortly before the November 2004 election CBS News aired on *60 Minutes* a segment on President Bush’s National Guard record. The segment was quickly shown to be based on faked documents, and Dan Rather was forced to admit that the documents were false. An independent investigation commissioned by CBS led to the firing of Mary Mapes, the producer of the segment, and three others. Dan Rather had earlier announced his retirement from CBS News and was spared disciplinary action. His role in the segment was widely derided, however. He was subsequently terminated by CBS.

As an example of the courts reducing a libel damages award, a jury had awarded \$222.7 million in damages to MMAR Group Inc. as a result of an article in *The Wall Street Journal*. The amount exceeded Dow Jones’ annual profit. The judge lowered the damages to \$22.7 million. (In 1999 the judge ordered the case retried because of the possibility that the plaintiff had misclassified evidence that the defendant could have used in its defense.)

**Comments of the Procter & Gamble and Neighbor to Neighbor Example:** This example examines the interactions between a firm and a media organization in the context of an interest

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<sup>19</sup> Swearingen, John E. “Responsibility in Journalism: A Business Perspective.” In *The Responsibilities of Journalism*. See Schumuhl (1984), pp. 100-1.

group attempting to use the media as part of its political strategy. The central issue is whether an advertiser should attempt to discipline a broadcaster. This following discussion looks at the issue from the perspective of Procter & Gamble and assesses its strategy alternatives.

Although the claim that purchases of Salvadoran coffee contributed to deaths in El Salvador may have some degree of truth, the link, if it existed, was likely to be quite indirect. Whatever the link, Neighbor to Neighbor had a political agenda, and its advertisements were one component of its political strategy.

The basic alternatives available to Procter & Gamble were to fight Neighbor to Neighbor or to make concessions. Concessions might be made either because Neighbor to Neighbor's allegation was true or because the pressure was harmful. Procter & Gamble could fight because of principle; i.e., Neighbor to Neighbor was wrong, and/or because it wished to establish a reputation for not making concessions to pressure groups. The advertisements probably had little impact on Folgers' sales, so concessions might not be required. Furthermore, Procter & Gamble could in all likelihood use its advertising power to reduce the probability that other stations or newspapers would publish the advertisement. The broadcast by WHDH-TV may also have been idiosyncratic to its management, since all the other (except one) stations rejected the advertising. This suggests that Procter & Gamble could uphold a principle without bearing a significant cost. Procter & Gamble could, and should at a minimum complain directly to the management of WHDH-TV.

If Procter & Gamble chose to fight, a defamation suit was probably not a realistic alternative. Winning was not likely, and a lawsuit would be costly. It would also add publicity to the issue if and when it went to trial. Withdrawing advertising involved some cost, since some sales would be lost, but a withdrawal would establish a reputation for not tolerating irresponsible actions by media organizations. (The withdrawn advertising dollars could always be shifted to some other Boston television station, so the loss in sales may not be significant.) Withdrawing its advertisements would result in some news coverage in the Boston area and in some national newspapers, but coverage would not likely last very long because of low audience interest. The other potential cost was that activists could be motivated by the withdrawal and might step up their attacks.

Whether a withdrawal of advertising would amount to an attempt to manage the content of the media depends on one's point of view. It is useful, however, to note that a withdrawal would not be because of news coverage or an editorial but rather would be due to a paid advertisement by an interest group. A withdrawal would be an explicit use of economic power, but that is surely within the rights of Procter & Gamble.

On the anniversary of the murder of the six Jesuit priests in El Salvador, Neighbor to Neighbor launched another attack and called for additional support of its boycott of Folgers coffee. WHDH-TV broadcast a news story on the issue featuring Mayor Flynn of Boston pledging that his city was joining the boycott. A sound bite from an interview with a boycott leader was also included in the story along with a P&G statement, read by the correspondent, to the effect that everyone was entitled to his own opinion.

The issue resurfaced in April 1991, when 10 Boston clerics, including priests, nuns, a Protestant minister, and a rabbi, conducted a vigil to force WHDH-TV to release the final version of the

Armstrong report. Father Jack Seery stated, “years have passed and 75,000 murders have occurred since they killed Romero, largely because the American people are kept in the dark.”<sup>20</sup>

Armstrong’s report was said to conclude that the coffee industry was behind many of the death squad killings. “Don Tassone, a spokesman for Proctor & Gamble, yesterday said that the draft of the report was filled with ‘false and misleading information’ about Folgers, which he said buys less than 2 percent of its coffee from El Salvador and does not have ‘operations on the ground’ in that country. ‘I know of no evidence from any reliable source linking our coffee purchases to violence in El Salvador,’ he said.”<sup>21</sup> WHDH-TV stated that the final report was a matter between P&G and itself.

Some restaurant and food-service customers expressed concern over the boycott and asked P&G if it could supply its Maryland brand coffee in a flaked grind which yields more cups per pound than does regular grind. Folgers is available in flaked grind but contains Salvadoran coffee, whereas some Maryland blends do not use Salvadoran beans but do not come in flaked grind. In response to customer inquiries, a P&G sales manager, Richard L. Francis, wrote customers that P&G was developing a Folgers blend without Salvadoran beans.<sup>22</sup> The boycott had led Pizzeria Uno to drop Folgers coffee, and other chains were under pressure. Francis wrote PepsiCo, whose fast food restaurants used Folgers, and PepsiCo planned to test the new blend. According to Tom Pirko of BevMark Inc., a consulting firm, “P&G wants to pacify a small segment, but the company doesn’t want the public mainstream to get the impression that it’s being bought by left-of-center consumer groups.”<sup>23</sup>

On the same day *The Wall Street Journal* carried a story about P&G’s plan to develop the new coffee blend, the Farabundo Marti National Liberation Front announced that in light of the progress being made in peace talks it would cease fighting in El Salvador. The U.S. Department of State had urged P&G to continue buying Salvadoran beans while United Nations peace talks to end the war in El Salvador were continuing.

The day after *The Wall Street Journal* reported that P&G would develop a Folgers blend without Salvadoran beans, P&G Chairman Edwin L. Artzt stated “our company will continue to use Salvadoran coffee beans in all our coffees whenever appropriate for blend-quality reasons... Simply put, we are not going to produce ‘boycott coffee’ for anybody.”<sup>24</sup> Mr. Artzt had been a consistent opponent of the boycott.<sup>25</sup>

As a result of a peace accord between the government and rebels in El Salvador, in March 1992, the boycott was called off. According to a report in *The Wall Street Journal*, “Neighbor to Neighbor said it now gives credit to P&G for efforts to ‘aid in the reconstruction’ of El Salvador.”<sup>26</sup>

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<sup>20</sup> *New York Times*, April 16, 1991.

<sup>21</sup> *Boston Globe*, April 16, 1991.

<sup>22</sup> *Wall Street Journal*, November 18, 1991.

<sup>23</sup> *Wall Street Journal*, November 15, 1991.

<sup>24</sup> *Wall Street Journal*, November 18, 1991.

<sup>25</sup> Mr. Artzt’s management style is described in an article in *Business Week*, February 3, 1992.

<sup>26</sup> *Wall Street Journal*, March 23, 1992, p. B3A.

## Cases

### General Motors Like a Rock (A)

This case presents a specific nonmarket issue that can be analyzed using the frameworks presented in the chapter. It illustrates the interaction between the market and nonmarket environments, indicates that managers are at the center of such issues, and serves as a focus for managerial decision-making.

General Motors provided a videotape of the Harry Pearce press conference with retractions by NBC and acceptances by GM. Also available from GM were two videotapes of Michelle Gillen's interviews with a GM engineer and an attorney representing GM in the Moseley case. The contact was: Mr. Ed Lechtzin, Director of Legal and Safety Issues, GM Communications Staff, New Center One Building—7305, 3031 West Grand Boulevard, Detroit MI, 48202. A segment on the GM pickup trucks was broadcast on the *McNeil-Lehrer Report*, November 30, 1993.

The issue has three components: 1) the dispute over the safety of the pickup trucks, 2) the *Dateline* program, and 3) the public's perspective on this affair. The issue that underlies all of these is safety.

With respect to the *Dateline* segment, it is clear (from the information presented in the case and subsequent disclosures) that NBC had fabricated the explosion and fire. GM concluded that this was the case, and management was incensed by NBC's false presentation. One alternative was to do nothing, and that was what some media advisors frequently advocate; i.e., get the issue out of the public's eye. In this case, however, GM should address the issue directly. In addition to the recent court judgment against GM, politicians and regulators might become more active on this issue. It is unlikely to go away, and activists would work to make sure that it does not. Indeed, the Center for Auto Safety planned a news conference in a few days.

A major decision for GM was whether to take this issue to the public or to deal with it behind the scenes. At some risk, GM decided that the right thing to do was to present its information to the public.

Another alternative was for GM to file a defamation suit against NBC News, which GM did. In this case, GM had quite a good opportunity to win, since it is clear that NBC fabricated the fire, falsely reported the events, and knew it was doing so.

The case discussion can be strengthened by drawing on the section on liability in Chapter 14. In the case of the GM pickups, NHTSA accident data indicated that for a year of driving the odds of dying in an accident in a GM pickup with exterior mounted gasoline tanks are one in 6,605, whereas the odds of dying in a Ford heavy pickup are 1 in 6,916 and for a Dodge the odds are 1 in 8,606. For a Nissan light pickup the odds are 1 in 4,521. Heavy pickup trucks were considerably "safer" than passenger cars.<sup>27</sup>

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<sup>27</sup> *Newsweek*, May 10, 1993.

One concern with the NHTSA accident records was that they do not control for how the vehicles were used, which could affect the frequency with which they were involved in accidents. A more informative approach would be to examine how safely the vehicle protects the passengers in an accident. Data from a study of fatal and major injury accidents indicated that per 1000 collisions GM C/K pickups had a lower rate of fatal and major injuries than did either the Ford F-Series pickup or the Dodge D/W Series Pickup. The frequencies are: GM 33.82, Ford 34.30, Dodge 35.21. For side impact collisions the frequencies of fatal or major injury were: GM 23.03, Ford 23.59, and Dodge 25.53. No statistical test, however, was likely to show that GM pickups were less safe than Ford or Dodge pickups. *Newsweek* titled the article cited in the previous footnote, “Just as Safe at Any Speed.”

Regardless of these data, safety activists argued that the GM pickups should be recalled. Their viewpoint was that if a hazard can be eliminated then it should be eliminated. NHTSA asked GM to voluntarily recall the C/K pickups, and it refused to do so. Secretary of Transportation Pena then announced a mandatory recall of the GM C/K pickups, and GM filed a lawsuit challenging the basis for that action. The Secretary quickly backed down, and GM and the Department of Transportation reached an accord settling the issue without a recall and with terms judged by observers to be quite favorable to GM.

The discussion of this case may be structured by asking the following series of questions in addition to the Preparation Questions at the end of the case.

### **Discussion Questions:**

1. What is the specific issue underlying the broadcast?
2. What were its origins?
3. Where is the issue in its life cycle?
4. Which interests are active on this issue? Which forces are moving this issue through its life cycle?
5. Which institutions will address this issue? Is this issue likely to be of renewed interest to members of Congress and federal regulators in NHTSA and the Department of Transportation?
6. What role does information play in the development of this issue?
7. What are the ethics dimensions of this issue?
8. Who in GM is responsible for deciding what to do about the *Dateline* story? (Answer: top management.) How should management interact with staff specialists; e.g., the general counsel?
9. Should GM pursue the *Dateline* story with NBC directly, in the courts, or in the court of public opinion, etc.? How should it implement its decision?
10. Suppose NHTSA asks GM to voluntarily recall the pickups. Should it do so?
11. Suppose NHTSA issues a formal recall order. Should GM contest it in the courts if it believes its pickups are at least as safe as those of other automakers?

The following is an assignment for a group presentation on the case. In the absence of a group assignment, the questions can be used to focus on the NBC *Dateline* story.

### **Group Assignment**

Assume that you work directly for the Vice President who heads GM's light truck division. Form a nonmarket strategy for GM that is sensitive to media and collective action concerns. Address the following specific questions:

- \* Should GM file a defamation lawsuit? If so, why, and what else should it do? If not, why not, and what should it do instead?
- \* Should GM withdraw its advertising from NBC? If so, which portions? News only?
- \* What direct contact with NBC, if any, does your strategy entail? Identify the range of NBC's responses and specify contingency plans.
- \* What sorts of communication with its employees should GM undertake?
- \* What policy should GM adopt if NHTSA responds to the CAS petition for a recall? Should GM cooperate or fight?
- \* Should GM try to meet with Ditlow of the CAS prior to his news conference?

The following (B) case provides an update.

## General Motors Like a Rock? (B)

Challenges to the safety of GM's trucks prompted the company to form a self-described "swat team" to address the emerging issue in a way that eliminated the rigid bureaucratic boundaries that often form in large businesses. The team included two public relations specialists, three attorneys, and two engineers.<sup>28</sup>

NBC asked GM for an interview two weeks prior to, and with no advance notification about, the "unscientific tests" to be conducted in rural Indiana. GM had a tradition of not going on camera if the interview might be edited, but William J. O'Neill Jr., GM's public affairs director for North American operations and a member of the swat team, convinced GM management that its policy was outdated. O'Neill's main argument was that the program would be far more destructive were GM to decline participation.

In advance of the first NBC contact, articles had begun to appear in various publications about alleged safety problems. Many of these were traceable to the Center for Auto Safety, which had asked the National Highway Traffic Safety Administration (NHTSA) to investigate. Although GM consented to go on camera for NBC, GM insisted first on replying to a NHTSA request for information on its trucks. To GM, the issue should be the overall comparative safety of its trucks and this, in turn, had a governmental regulatory component as well as public relations and media components. GM seems to have anticipated questions from NBC on regulatory compliance, so it wanted to make sure its answers were truthful and non-damaging.

GM proposed three conditions for the interview with NBC. First, the interview had to be with an engineer and lawyer together. Second, Mr. Read (the *Dateline* producer) and Ms. Gillen (the reporter) had to spend several hours with GM officials before the interview to run through the material so they understood GM's views. Third, GM was to be allowed to tape NBC taping GM. According to Edward S. Lechtzin, director of legal and safety issues for the GM communications staff, the third condition "almost scrubbed the project."<sup>29</sup>

O'Neill and Lechtzin met with Read and Gillen for two hours on November 12, 1992, to go over the ground rules for the interview. Read and Gillen reiterated NBC's opposition to interviewing a lawyer and engineer together, but GM stood firm given its expectation that some questions would be of a legal nature and pertain to upcoming product-liability litigation. Eventually, the parties consented to proceed as GM wished.

The interview session was described by Lechtzin as follows:

It was no interview session. It was a medieval inquisition with modern torture devices: hot lights and the unblinking TV eye. Of the four hours under the hot lights, about three

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<sup>28</sup> One of the public relations specialists was Edward S. Lechtzin, author of "One Year After the Infamous *Dateline* NBC Test-Crash Show, GM Executive Tells How Automaker 'swatted' back," *TJFR Business News Reporter*, December 1993. Lechtzin's article was helpful in the preparation of this case, but as such raises the possibility that the case itself is in part an outcome of GM's strategy. The case should be read accordingly, though it attempts to be neutral and objective.

<sup>29</sup> *TJFR Business News Reporter*, December 1993, pp. 4-5.



hours were taped. We could have been out of there in less than five minutes if we had just answered two repeatedly asked questions the way they wanted. The questions were “How many people have you knowingly killed?” and “You knew that you put a defective product into the marketplace. Why haven’t you changed it?” That’s all we had to do, answer those two questions they wanted so they would have a good sound bite and we would have been out of there. We had two magnificent people on camera and would put them up against any interviewer.<sup>30</sup> Near the end of four hours, in spite of the incessant repetition of the key questions in varying disguises, Mr. Read didn’t have the sound bites he wanted and was literally screaming questions for Ms. Gillen to ask. That’s when we decided we’d had enough and said, “No more!” Print journalists who have viewed the entire interview tape have asked why we didn’t walk sooner. They know they wouldn’t have been given that amount of time with that approach.<sup>31</sup>

The GM team watched the *Dateline* show together when it aired in November. Of the three hours of interview tape one minute was used on *Dateline*. Concluding that the coverage was unfair, a GM lawyer, Mr. William Kemp Jr., proposed immediately that a letter be sent to Mr. Read of NBC. Many of the ensuing communications are described in the case, *General Motors Like a Rock? (A)*.

Approximately two months elapsed before knowledge of the more incendiary details of NBC’s journalism reached the very top level of GM management. GM’s president, John F. Smith Jr., first heard of the rockets at President Clinton’s inaugural ball in January when O’Neill pulled him aside. Smith’s first reaction was “You’re kidding me.” His second reaction was, “Don’t overplay it, but do what’s right.” It remained the task of the small, flexibly organized SWAT team to form and implement a specific strategy consistent with Smith’s general advice.

As GM’s investigations progressed, the team repeatedly asked two questions: “Do we have enough information?” and “Are we doing the right thing?” By early February the practical answers to these questions were “yes.” Timing played a crucial role in the implementation of GM’s nonmarket strategy. The rock and the hard place between which GM was caught were the announcement of the Moseley verdict at the end of the first week of February 1993 and the anticipated collective action the following week by the Center for Auto Safety (CAS). The Moseley verdict and the media attention it generated formed an ideal news hook on which the CAS could hang its less-than-delicately dubbed crusade, “Campaign GM Firebombs.” GM’s timing objective was to preempt media-facilitated collective action in the regulatory arena by going on the offensive against NBC.

The kickoff event was a GM press conference at 1:00 p.m. on Monday February 8. By holding a conference in which the bulk of GM’s findings would be made public, the SWAT team realized that it ran a high risk of media organizations “circling their wagons” to protect their own. The bold prediction, however, was that GM could show that NBC had been so clearly irresponsible in its coverage that other media would be reluctant to come to NBC’s defense. To the extent that any self-criticism within media would arise, GM stood to benefit at the margin from more balanced coverage after GM exposed the unknown facts about NBC’s coverage. More balanced coverage, in turn, would be helpful if and when interest groups such as the CAS persisted in their efforts to propel the pickup recall issue into public view.

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<sup>30</sup> Both were GM executives. Their names are not given.

<sup>31</sup> *TJFR Business News Reporter*, December 1993, p.5.

GM's spokesperson at the press conference was Harry Pearce, executive vice president and general counsel. (Years earlier Pearce successfully litigated a GM-NHTSA dispute regarding the proposed recall of GM's X-cars with allegedly defective breaks.) For two hours and seven minutes, he addressed 150 print media journalists and 25 camera crews. The conference was broadcast over closed circuit TV to GM dealers and major suppliers across the nation. Also watching were NBC executives in Rockefeller Center in New York. Pearce presented a well-orchestrated sequence of exhibits, video footage, and photographs, making frequent references to the recovered trucks that were on display for reporters' inspection. Part of the conference gave an account of GM's communications with NBC, part of it described GM's persistent efforts to recover evidence about the NBC tests, and a great deal of it focused on the issue of overall comparative truck safety, as opposed to safety only in side-impact crashes in which a fire occurred. On the whole the audience seemed attentive and receptive.<sup>32</sup>

GM spent about \$90 million in advertising on all NBC programs through the first three quarters of 1992, so withdrawing all of its advertising from NBC would be significant. Instead, the strategy adopted was to temporarily shift advertising from NBC news programs to NBC entertainment and sports programming. The explanation offered by GM for this decision provides clues about the depth of principles underlying the advertising strategy. O'Neill said that GM did not pull its advertising from NBC's entertainment or sports programs because this advertising was a good value.<sup>33</sup>

Another component of GM's strategy was to file a defamation suit against NBC, the first ever by GM. This was announced early in Pearce's conference but downplayed thereafter. Considerable action occurred behind the scenes, however. In the aftermath of the press conference, which was covered extensively by major newspapers, GM set its sights on prime time television on Tuesday evening, February 8. Negotiations began between Pearce and NBC executives regarding a *Dateline* retraction. GM considered itself in a strong position after the press conference and its coverage by other media, but as *Dateline* began its broadcast on Tuesday, no agreement had been reached. Within the hour, however, the eye of the media blinked: NBC agreed to broadcast a retraction. The final agreement on wording was reached only five minutes before hosts Jane Pauley and Stone Phillips began reading it. The retraction itself lasted 3.5 minutes, which commentators later called an eternity by TV standards.<sup>34</sup>

Following NBC's retraction, Harry Pearce also made an announcement: "In view of NBC's announcement, and because it is our business to design and manufacture great cars and trucks and not to be preoccupied with litigation, we are tomorrow dismissing the defamation suit that we brought Monday. NBC will reimburse General Motors for its actual costs of this investigation."<sup>35</sup>

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<sup>32</sup> Lechtzin described the journalists at the conference as "mesmerized." Although this may be an overstatement, GM's satisfaction with Pearce's performance is reflected by the willingness with which the company provides a free copy of the videotape to those who request it.

<sup>33</sup> *New York Times*, February 11, 1993.

<sup>34</sup> GM also appended a video copy of the retraction to its press conference tape.

<sup>35</sup> General Motors press release, February 9, 1993. Elsewhere it was reported that GM incurred approximately \$2,000,000 in expenses. NBC's crash tests, in contrast, were estimated to have cost \$4,200

The ripple effects of the GM-NBC confrontation on collective action and regulation are difficult to measure, but at least some evidence suggests that the consequences were favorable to GM. First, although the Center for Auto Safety held its press conference on February 9 as planned, the conference received significantly less coverage than NBC's extraordinary retraction. Second, although the issue of recalling pickups did not go away entirely, subsequent media treatment of recall efforts usually summarized the main "overall safety" arguments GM had made to counter NBC's imagery.<sup>36 37</sup> Finally, communications from GM management to GM employees were extensive during the crisis period. The consensus within the company was that GM's strategy and its implementation provided a significant boost in company morale.

### **Postscript: NBC**

Morale at NBC was a different story. It dropped precipitously. "Many people at the network felt that [the *Dateline* incident] was a result of NBC's ratings-at-whatever-cost atmosphere. Matters weren't helped when Mr. Wright, NBC's president, told employees [in March] that the problem . . . wasn't so much that it happened, but that NBC got caught."<sup>38</sup>

A more critical assessment originated with NBC's hiring of an outside firm to investigate the *Dateline* news division. The firm issued a report that highlighted several major "lapses" within the division overall.<sup>39</sup> Meanwhile, the ruminations and fates of individual NBC employees were mixed.

- Robert Read (producer of "Waiting to Explode?") stated at one point that he was "happy that NBC's report vindicates the fundamental honesty of the GM segment. There was absolutely no intention to deceive."<sup>40</sup> This was not a consensus opinion. Read was fired.

- David Rummel (*Dateline* senior producer) and Jeff Diamond (*Dateline* executive producer) resigned from NBC. They went to work for ABC's news magazine *20/20*.

- Michael Gartner (NBC News president) also resigned but claimed that he had wanted to go back to Iowa with his family anyway. He ran the Ames *Daily Tribune*.

- Michele Gillen (NBC reporter) mounted a behind the scenes campaign within NBC to acquit herself, claiming to have objected to the segment. She was reassigned to NBC's Miami affiliate as an anchor.

- Three other NBC employees were criticized in the commissioned report but not reprimanded.

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<sup>36</sup> In November 1994 GM announced a voluntary recall on pickups for fire hazards, albeit on its newer pickups that no longer use sidesaddle tanks ( *New York Times*, November 22, 1994). Also in November, the *MacNeil/Lehrer Newshour* ran a segment on attempts to recall the older trucks. Relative to *Dateline* a year earlier, the segment was balanced. For example, considerable airtime was given to a professor of the Yale Law School who specializes in regulatory issues and who described and quantified the often-overlooked costs as well as benefits associated with recalls. But the segment had a more conventional news-magazine controversy-seeking component as well. Clarence Ditlow of the CAS was interviewed as were safety advocates who had picketed various GM dealerships. When asked whether dealers had been responsive to their concerns, one protester told an interviewer that, yes, dealers were responsive in a way: they responded by piping music through their loudspeakers on the car lot. The music played was "Light my fire."

<sup>37</sup> The article in *Newsweek*, May 10, 1994, is representative.

<sup>38</sup> *Wall Street Journal*, March 2, 1993.

<sup>39</sup> GM provides a copy of NBC's commissioned study in its information packet.

<sup>40</sup> *New York Times*, March 23, 1993.

- Jane Pauley (*Dateline* co-anchor) tried to boost morale at NBC at a major staff meeting after the retraction. Members at the meeting said “Ms. Pauley had delivered a pep talk in which she said she took a ‘perverse sense of pride’ in acknowledging the mistake. She also emphasized that both she and her husband, the cartoonist Garry Trudeau, found Tuesday night’s edition of the program, which included investigative reports on the insurance fraud and tainted meat, one of the best segments the program has ever done.”<sup>41</sup>

In its retraction on *Dateline* Jane Pauley and Stone Phillips acknowledged that NBC knew that incendiary devices had been put under the trucks and that the fire occurred because in the crash gasoline was forced out of the filler tube because the fuel cap did not fit the tube. NBC did not dispute GM’s conclusion that there was no puncture in the gas tanks and that the impacts were at speeds significantly higher than stated in the broadcast. NBC concluded by announcing a new policy. “We have also concluded that unscientific demonstrations should have no place in hard news stories at NBC. That’s our new policy.”

GM had settled a class action lawsuit by 650,000 Texas owners of the pickup trucks by agreeing to provide \$1,000 discounts to owners on the purchase of a new GM pickup truck. A Texas appeals court, however, threw out the settlement on the grounds that the value of the coupons was low, since most people would not choose to purchase a new GM pickup truck.

In April 1995, the federal Court of Appeals rejected the settlement of a lawsuit in federal court that provided \$1,000 coupons to all owners of GM pickup trucks with sidesaddle gas tanks. The appeal had been made by the Center for Auto Safety. The Court of Appeals ruled that the coupons had little real value and were a “sophisticated marketing program.”

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<sup>41</sup> *New York Times*, February 11, 1993.

## The News of the World

This case reports on the early stages of *The News of the World* scandal. As more information has been revealed, the scandal has become more detailed and complex. Criminal charges have been filed against several of the players, including Rebekah Brooks who was charged with “conspiring to pervert the course of justice.” Rather than attempt to recap the developments, this note discusses teaching the case.

The case is intended to serve as a vehicle for assessing the incentives of journalist and the news media and the restraints, or lack thereof, on their behavior arising from the law and professional standards. The behavior in this case may have been present in other UK newspapers as well as at the *News* and possibly the *Sun*, but the discussion here focuses only on the News Corp. papers.

British tabloids have traditionally been competitive and have a record of uncovering and disclosing scandals and private information such as sex scandals. The incentives to get a “scoop” on a celebrity, government official, or a royal such as Prince William are apparently quite strong and evidently can lead to breaking the law and professional standards. Since information is at the heart of the matter, it is useful to discuss the sources of information. One is traditional investigative journalism, an example of which is Woodward and Bernstein’s uncovering of the Watergate affair. Another is paying sources, which apparently is not uncommon particularly when it involves private sources. A third is hacking into cell phones, which apparently was a fairly widespread practice at least as far as Mulcaire as evidenced by his notes. A fourth is paying government officials for information they are not authorized to disclose. The third and fourth clearly violate the law and professional standards and the second may violate professional standards but not the law. Paying police officers may constitute bribery under UK law. The third and fourth may also violate EU data protection directives. (See Chapter 15 and the chapter case *The European Union Data Protection Directive (B)*.)

The law and professional and ethics standards were not sufficient to deter this conduct, which shows either the strength of the incentives or an attitude that the people’s “right to know” prevails over the law and standards.

One concern about the seriousness of obtaining the information is how it might be used. It could be used to generate newspaper sales, as was likely with Prince William’s knee operation. Another would be to extract favors from the subject of the information. A third is for extortion. How the information obtained and how it was used may be revealed in the upcoming trials.

Was there a cover-up of the incidents by the *News*? Apparently so, which means that high ranking editors and executives were aware of the illegal activities. The hiring of the law firm to investigate the reported incidents seems foolish given the self-evident facts that must have been known to the *News* officials and likely James Murdoch. Lord Macdonald’s comment seem convincing on this issue.

A disquieting aspect of this case is the close contact between News Corp. executives and government officials, including the present and preceding Prime Ministers.

Another topic for discussion is the effects on the companies and their employees. The News was closed down, and the UK government objected to the acquisition of the additional shares of BSkyB.

**Update:** In late November James Murdoch stepped down as director of two of the Murdoch group's newspapers. Commentators speculated that the News Corporation might withdraw from the UK newspaper market.

In 2012 News Corporation announced that it would split into two publicly traded companies, one of which would contain the entertainment businesses and the other the publishing businesses. Rupert Murdoch would be chairman of the board of both companies and the CEO of the entertainment company. The financial markets had been calling for separating the two lines of business.

Inquiries and investigations as well as trials were still under way as of mid-2012.

## Chapter 4

### Private Politics and Social Pressure

This chapter introduces the concept of private politics and distinguishes it from public politics, which is the focus of Part II of the book. The private and public politics terminology is maintained throughout the book. Private politics is typically initiated by NGOs and activist organizations, but as the National Audubon Society example below indicates, it can also be used by business interests. The participants in private politics are viewed as strategic, in the same sense that a firm chooses market and nonmarket strategies to improve its performance. Private politics is also viewed as competition, and that competition often centers on a campaign. The two Rainforest Action Network cases reflect this perspective.

In addition to characterizing the NGO/activist component of the nonmarket environment and highlighting actions that take place outside of public institutions, the chapter also addresses approaches for dealing with activists and their campaigns. Activists are important for the variety of reasons indicated in the chapter and especially because they play a central role in identifying and shaping the development of nonmarket issues. Some activist groups, such as environmental interest groups, are members of informal networks of organizations that at times coordinate their actions.

Activist/NGO challenges to firms are intended to obtain changes in the practices of individual firms and their industries. In response to these challenges, some firms take proactive measures by changing their practices to avoid being targeted. This may be referred to as self-regulation. Proactive self-regulation and corporate social responsibility do not mean that a firm will not be targeted, however, as Starbucks has learned. Firms that are targeted can fight a campaign or bargain with the activist to end it. When the firm changes its practices as a result of a campaign it is also exercising self-regulation, albeit forced self-regulation. In some cases, such as the Nike campaign considered in the chapter case *Nike in Southeast Asia* and in Chapter 24, an industry and the activists may engage in private regulation in which an organization, or private institution, is established to govern industry practices and compliance. The Fair Labor Association governs the conduct of participating footwear and apparel companies.

In Part II, an interest group is defined as a collection of individuals or organizations that benefit from the nonmarket actions of the group. That is, the interest group acts on behalf of its members, typically through public politics. Activists may also be acting in their own self-interest and in the interests of their members, but they generally claim that they are acting on behalf of others as well. Some prefer to refer to themselves as advocates.

The susceptibility of a company to a challenge by activists depends on a variety of factors including the seriousness of the issue and on characteristics of the company itself and its policies. Figure 4-1 can be used to assess a company's susceptibility and can be applied in the *Shell, Greenpeace, and Brent Spar* and the *Nike in Southeast Asia* cases. A generic strategy used by activists is presented in Figure 4-2 and can be used to analyze the activist strategies in these two cases. The figure can

also be used to summarize on the board the strategy being deployed against the company and its practices.

The chapter case *The Anatomy of an Activist Campaign: Rainforest Action Network and Citigroup (A)(B)* deals with a campaign and provides an opportunity to consider strategic responses by the target Citigroup. As indicated in the text, a companion case *Strategic Activism: The Rainforest Action Network* provides insight into an activist organization and its strategy.

The success of the strategies of activists depends importantly on their ability to attract the attention of the public and government officeholders to their cause. They may attempt to attract the media through the use of advocacy science and through networks. In addition, activists monitor firms and may call to the attention of the public actions of a firm to which they object. Activists may organize a boycott of a company. Activists also use their standing before public institutions to leverage their other actions, either when other aspects of their strategies fail or when an additional front can be opened to advance a cause.

For an example of a cooperative NGO see the article “Nature’s Own Hedge Fund” (*Bloomberg BusinessWeek*, June 4—June 10, 2012) which focuses on Mark Tercek, the head of the Nature Conservancy. Among other things the article discusses a cooperative engagement with Dow Chemical in which 20 Nature Conservancy scientists are working with Dow to identify its “global land and water assets.”

An article with discussions of cooperative engagements of firms with activists/NGOs is *Business Week*, March 12, 2007.

Although some activists are successful, particularly when they are able to attract additional support, others have relatively weak organizations and are unable to sustain campaigns. In some cases, the cause of the activist may be wrong or misplaced, and the responsible action may be to oppose the demands. Some of the cases provide an opportunity to assess the demands of activists, their strength, and their cause.

The following is an example of private politics that could be used in a lecture. The National Audubon Society produced a television special “Ancient Forests: Rage Over Trees,” which was to be broadcast on the Turner Broadcasting System’s cable channel WTBS as part of its regular airing of the “World of Audubon” series. The special dealt with the logging of old growth forests in the Northwest, which has been the source of a long-standing conflict between environmentalists and loggers. The timber industry in the Northwest has been economically depressed for a number of years, and the long-term prospects have not been good, particularly since timber companies had concluded that the cost of harvesting timber in the South is lower than in the Northwest. Old growth stands of timber thus represented an important source of employment for loggers in the Northwest.

Although Peter A.A. Berle, president of the National Audubon Society, said that the program was “balanced,” he stated that “the script does have a pro-environment attitude.” To oppose the special, the loggers organized a boycott of the sponsors of the program, and their pressure caused the Stroh Brewing Company, the Exxon Corporation, the Michelin Group, Ford Motor Company, and Sears, Roebuck to withdraw their advertisements. The program was aired with only public service



announcements. William N. Grannell, executive director of the Western States Public Land Coalition of Pueblo, Colorado, claimed some credit, “Our people got the word out and told Stroh’s beer that if they sponsored such a program, well, our members would not be so inclined to drink Stroh’s beer any longer. I’m just glad these companies became sensitive to our side of the issue.”<sup>42</sup> Stroh’s had contributed \$100,000 to the Audubon Society for its specials.

## CASES

### **Shell, Greenpeace, and Brent Spar**

The Brent Spar episode had a dramatic impact on companies such as Shell and British Petroleum. The episode indicated how easily and quickly a nonmarket issue within the jurisdiction of one country can spill over to other countries in which the company operates. The lesson particularly for global companies is that nonmarket issues, and particularly those that are being pursued by activists, can through modern telecommunications spread widely around the world. For more information on Brent Spar and the disposal of deep-sea platforms, consult Brent Spar’s web site [www.shellexpro.brentspar.com](http://www.shellexpro.brentspar.com) and Greenpeace’s web site [www.greenpeace.org](http://www.greenpeace.org).

#### **From Greenpeace’s Perspective**

The case describes the events and the outcome, so the discussion here focuses on the teaching of the case. It is useful to begin the discussion from the perspective of Greenpeace, since this is a confrontation, or competition, between Greenpeace and Shell both in governmental institutional arenas and in the arena of public sentiment. That is, it is helpful to view the issue from the perspective of one’s adversary.

The first question is, “How does Greenpeace view the issue?” Greenpeace understands that the North Sea is a maturing oil province and that many of the deep-water platforms will be scheduled for disposal in the near future. Amoco has already prepared its BPEO for the NW Hutton platform, and Conoco was preparing its BPEO for the Heather field. Greenpeace understands that if it wins the first battle (Brent Spar) it will have won the war. Greenpeace is thus playing a repeated game against a series of platforms and the oil industry and has strong incentives to win this battle. Indeed, Greenpeace organizes around “campaigns.” In contrast, Shell is focusing on the disposal of one platform—Brent Spar. Moreover, Shell views the Brent Spar as a unique facility because it is a storage buoy rather than an oil production platform.

The next question can be about Greenpeace’s objective. One obvious answer is that its objective is to protect the oceans. It commissioned a study that concluded that at sea disposal was a bad alternative. Another answer that students give is that it wants a high profile campaign that will give it publicity and help it raise contributions and obtain new members. Another answer is that it is seeking a bully pulpit from which it can espouse its views. A final possibility is that it seeks to be the leader in the international environmental movement.

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<sup>42</sup> *Wall Street Journal*, September 25, 1989.

The next question is “Who are these people?” The answer is that they are experienced professionals who do this type of campaigning on a full-time basis. For example, the head of communications for Greenpeace was a former BBC journalist.

Next, “What are its capabilities?” Greenpeace has ships, a helicopter, and sophisticated telecommunications equipment. It is experienced at battles at sea and fully capable of placing its people on a storage buoy even when it was under tow to the disposal site.

Greenpeace’s strategy is to take its concerns about deep-sea disposal to the public and to governments and to do so it must attract media coverage. The theory of the media in Chapter 3 can be used to assess the likelihood that its Brent Spar actions will be covered and how they will be treated. Environmental issues attract an instant audience particularly in Northern Europe, so the audience interest is present. The issue of the deep-sea disposal of oil platforms is complex, so the news media may treat the issue fairly objectively. However, Greenpeace members will be given the opportunity to express their concerns about damage to the environment and to present their conclusions, so the treatment of the issue will serve Greenpeace’s objectives.

To fully characterize Greenpeace’s strategy, it is useful to draw Figure 4-2 listing the steps Greenpeace took to get its messages to the public and to government officials in Europe and worldwide. Attracting the media was central to its strategy, and to do so it positioned itself not only as a low-cost source of information but it also staged events to make the story more newsworthy and attractive to audiences. To reduce the cost to the media, Greenpeace not only broadcast from its ships and from the Brent Spar, but it also brought along journalists to film and view the events. The events were attractive to television viewers and newsworthy. Greenpeace demonstrated courage and resolve, and small rubber dinghy’s bouncing on the high seas under chase from Shell’s boats made great footage for the television cameras

The messages that Greenpeace conveyed were simple. It had studied the issue of the disposal of oil platforms and concluded that deep-sea disposal would harm the environment. Moreover, it was able to portray Shell as indifferent to the harm that its littering of the ocean bottom would cause. Casting Shell’s plans as something that ordinary citizens were not allowed to do was quite effective. In contrast to some of Greenpeace’s other campaigns, the messages were simple and easy for substantial segments of the public to accept.

Shell was unable to convey effectively its side of the story. It had two natural disadvantages. First, its side of the story was complex and technical and not easily presented on television (although it was presented in newspapers). Moreover, a long discourse on the reasons for Shell’s choice would have been boring to most viewers. Second, deep-sea disposal was considerably less costly than were the alternatives, and skeptical journalists and audiences would naturally wonder if Shell had made its BPEO decision based on cost rather than environmental considerations.

Shell’s culture also limited its ability to respond to Greenpeace’s messages. Shell had traditionally been a quiet company and did not communicate directly with the public. In the Brent Spar episode a BBC executive told me that they had to “beg Shell to tell its side of the story.” She added, “When they told it, they told it clumsily.”

Shell's response of shooting water cannons at Greenpeace's helicopter not only created vivid visual images for television viewers, but it also created a story within the story. That is, it cast Shell as big business beating up on the little guys in their small helicopter and rubber boats. This also extended the story. Greenpeace's call for a boycott of Shell products also extended the story and gave it a life of its own.

At this point it is useful to ask why the reaction in Germany was much stronger than in the United Kingdom and to present the answers in terms of Figure 3-2 and the audience interest and societal significance dimensions. One explanation is that the public is more environmentally sympathetic in Germany than in the UK, as evidence by the recycling required in Germany and its recent generous subsidies for solar and wind power. Moreover, Germany has a Green Party, which in 1998 joined in the government with the Social Democrats. Germans also are major contributors to Greenpeace's budget. Importantly, Germany has no North Sea oil production, whereas the UK has substantial production. In Figure 3-2 Germany would be toward the upper right corner, whereas the UK would be located down and to the left. A follow-up question could be where Norway would be on these dimensions. The answer is that it likely would be further down and to the left, due to the importance of North Sea oil to its economy.

Greenpeace had been beset by an internal disagreement between the "rubber suits" and the technocrats. The rubber suit contingent wanted to dramatize what they viewed as egregious actions harmful to the environment. The technocrats preferred to participate in public processes to find creative solutions to environmental problems. In this case, the rubber suits prevailed.

Another question is whether Shell was particularly vulnerable to the type of actions taken by Greenpeace and whether it was vulnerable to a boycott, as indicated by the list in Figure 4-1. The answer is that it is highly vulnerable—less so in the United Kingdom and more so in Northern Europe. Shell is a company with a brand name, and consumers can easily switch to other brands. Shell also has a reputation that can be damaged just as Exxon's was as a result of the Exxon Valdez oil spill in Alaska. It also operates in an interest group-rich environment in Europe. As considered in more detail below, it was also a highly decentralized company, so an issue that could spill over to other parts of the company could go unrecognized until it is too late.

One issue that is taken as given in the case is that Shell was the first company to attempt to dispose of a large deep-sea platform in the North Sea. But, why was Shell first. An Amoco manager told me that Amoco was ready to dispose of the Northwest Hutton platform but feared going first because of the possible protests. Amoco chose to continue to operate the platform at a loss rather than go first. Amoco continued to operate the platform and recently sold it to a company that may attempt to dispose of it.

### **What went wrong?**

This question can be addressed to the decision regarding the disposal of the Brent Spar and to Shell's response once Greenpeace had launched its campaign. The disposal decision involved both Shell and the UK government, and the processes in both were relatively closed. In preparing the BPEO, Shell generated the disposal alternatives internally and evaluated the alternatives itself with the assistance of consulting companies. Shell viewed the Brent Spar as a unique facility and

focused on its disposal. There is no evidence that Shell was thinking of the broader issue of the disposal of a series of North Sea oil platforms. Instead, it viewed decisions as made on a case-by-case basis. Shell also focused on the UK, since the UK had sole jurisdiction over the disposal.

In particular, Shell UK did not consult with other Shell operating companies about the disposal of the Brent Spar. Shell is a highly decentralized company with operating companies responsible for their own function and/or region. Shell UK worked with Shell Expro but not with other operating companies. This decentralized organization structure stood in the way of detecting a potential reaction outside the UK. Information within Shell tended to flow up to the holding companies and then down to the operating companies, rather than directly between the operating companies.

The government approval process was also closed. First, note that due to UK law the Department of Energy was responsible for approval of the BPEO and not the Department of the Environment. The latter department was held in low regard in Prime Minister John Major's government. Second, the process was closed with consultations held only with officially designated parties such as Scottish Heritage and the Nature Conservancy. These also included legitimate users of the seas such as the fishing industry and British Telecom (undersea cables). Public hearings were not held nor was there apparently any opportunity for public commentary. Instead, the approval process focused on technical feasibility and hazards to the environment and to workers. The notification of other governments about the Department of Energy's approval of deep-sea disposal as the BPEO was made at the ministerial level (i.e., bureaucrats rather than politicians). Since the UK government had sole jurisdiction, the ministries in other countries did not object. Note that the reaction of politicians, particularly when the public protests began, was markedly different.

What is most remarkable about this episode is that after the protests on the continent and in the UK and after other European heads of state had asked the UK government to halt the disposal at sea, Shell began to tow the Brent Spar to its disposal site exactly when it had planned to do so. It is important to recall that towing Brent Spar to its disposal site would take four weeks, giving Greenpeace many opportunities to reboard.

The protests escalated rapidly as Greenpeace successfully landed two of its people on the Brent Spar. It is also perplexing that after the first set of protests the head of Shell Germany did not attempt to intervene with Shell UK. Instead, the issue had to be resolved at the top of the Company.

Once Greenpeace had launched its campaign, the issue had advanced to the point in Figure 2-3 at which Shell was in crisis management mode. Shell was certainly experienced with crisis management and had well-established procedures for dealing with an oil spill or refinery explosion, for example. For whatever reason, there is little evidence that it had a crisis management plan for its nonmarket environment. One possible explanation is that Prime Minister John Major had publicly backed Shell's decision, and if Shell had postponed or reversed its decision when protests erupted, it would have left the Prime Minister hanging out on a limb all alone. Once Shell did back down, it publicly and privately apologized to the Prime Minister.

In evaluating the BPEO process Shell completed, it is useful to ask four questions. “Is this an energy issue or an environmental issue?” “Is this a Shell UK issue or a Royal Dutch Petroleum/Shell Transport issue?” “Is this a Royal Dutch Petroleum/Shell Transport issue or an oil industry issue?” “Is this a UK issue or is it a European or world issue?” The answers suggest how this type of issue should be handled.

A different approach to the issue of what went wrong is to ask whether Shell should have anticipated this. The answer is probably yes, but it more instructive to ask a related question, “Why was Shell first?” One answer is that it did not recognize the possibility of a reaction, but the better answer may be that Shell was first because no other oil company was willing to be first. Amoco had completed its BPEO before Shell completed its BPEO, but Amoco recognized the possibility of a reaction and chose not to be first. Not only did no oil company want to go first, but after Brent Spar no oil company wanted to go second. Amoco operated the NW Hutton platform for the next five years at a substantial loss because it did not want to be second. The same was true for all oil companies that had an oil platform that should be disposed of. A change resulted in 2001. Amoco sold NW Hutton to Oryx Petroleum, which planned to dispose of the platform by dismantling it in Norway and recycling the top of the rig. Oryx apparently bought another field and was preparing to dispose of another platform.

The following questions can be used to conclude the discussion:

1. Should Shell have backed down or gone through with its plan to sink the Brent Spar in the North Atlantic?
2. Once it had backed down, what should it do to develop a new BPEO?
3. How should issues in which there is a risk of spillover to other nonmarket environments be handled in the future within Shell?

### **Developments:**

As indicated, the new Labour government of Tony Blair gave the Department of the Environment a role in the approval of BPEOs. The UK Department of the Environment announced that all future disposals would be on land.

## **Nike in Southeast Asia**

Nike is known worldwide for its distinctive “Swoosh” symbol and its extensive advertising and promotional activities. Nike has also earned a reputation as an aggressive and combative company whose objective is to beat its rivals. Nike’s “edge” is reflected in Phil Knight’s comments such as “blasts from the media about our practices abroad,” his comment that workers in suppliers’ factories were earning more than they used to, his argument that Nike was good for the countries

from which it obtains its shoes and apparel, and his offer to let the Congress members tour the factories. Nike was also the dominant company in the footwear industry and had grown rapidly. Nike was an obvious target for activists and organized labor.

Nike was also a big target. It had 350 overseas suppliers employing 500,000 workers with 180 suppliers in Asia employing 350,000 workers. This also meant that it was a formidable task to ensure that at each facility the working conditions met appropriate standards at all time. More importantly, what should those standards be?

Nike had never produced its own shoes, relying on a set of contractors with whom it maintained long-term relationships. Its principal contractors were Korean and Taiwanese companies, and its shoes had been produced in those countries. As those countries developed, labor costs increased and its contractors moved production to low-wage counties, primarily China, Indonesia, and Vietnam. Many of its suppliers' factories produced only for Nike. The footwear and apparel industries are competitive, and there is considerable pressure to keep costs down. To accomplish this, productivity must be high and wages low. Nike's suppliers' factories were efficient. Moreover, most of the factories were modern. The criticisms of Nike's practices centered on the wage level, the employment of children, and abusive practices.

Employment of children is customary in many low-income countries. Levi Strauss & Co. sources much of its apparel in East Asia and has been a leader in developing and implementing policies to ensure acceptable standards at its suppliers' facilities, yet its guidelines allow employment of children as young as 14 if the law allows it. The development of Levi Strauss & Co.'s policies is considered in Chapter 23.

Concerns about the conditions in the factories of overseas suppliers began to mount at the beginning of the 1990s particularly as the recession in the United States highlighted the movement of manufacturing jobs to countries in East Asia. The principal activists were human rights groups such as Global Exchange and labor unions. The human rights groups were concerned with the abuse of labor rights of workers. Labor unions were also concerned about labor rights but were perhaps more concerned about protecting jobs for their members in the United States. The movement of production from the United States to East Asia resulted in the loss of union jobs, and the unions sought to stem the flow. One way to do so was to raise the costs of overseas production. The labor unions thus focused on wages and health and safety conditions. Women's activist groups were also involved because most of the employees were women. The human rights organizations, women's groups, and organized labor were aligned on this and other issues. Members of Congress also supported the critics.

Three issues were central to the criticisms. The first was the abusive treatment of workers, such as the well-publicized incidents described in the case. The second was health and safety standards in the factories. The activists and labor unions argued that the same standards applied in the United States should be maintained in factories that produced for export to the United States. The third was wages with activists and labor unions arguing for a "living wage" rather than the market wage or the minimum wage set by the government.

The media was attracted to the issues. The level of audience interest was moderate, but the issue of abuse of rights and unfair treatment of workers earning a few dollars a day to produce shoes that sold for \$140 in the United States was viewed as high on the societal significance dimension. The news media treated these issues in its roles of protector of the people and exposé of injustice. Incidents of abuse and protests as at the Indonesian and Vietnamese factories increased the drama and criticism. The label given to the factories by critics and the media was “sweatshops,” and the revelation of sweatshops employing legal and illegal immigrants in the United States added to the audience interest in the issues.

Throughout this period Nike had taken some modest steps to address the issues, but the arena of public sentiment and media coverage was largely left to its critics. Nike left a vacuum that its critics filled by framing the issues and using the worst conditions and events as examples. Nike contended their allegations, and the facts remained in doubt. Nike’s response was generally reactive and confrontational, rejecting the claims and arguing that its sourcing of shoes and apparel in Southeast Asia was good for the countries and the workers.

Explanations for Nike’s approach to these issues centered on its aggressive corporate culture and on its past experience in dealing with activists and media criticism. Nike had come under attack from the Reverend Jesse Jackson and Operation PUSH for not employing enough African-Americans and purchasing enough from African-American companies. Nike rejected the allegations and fought Jackson, as described in the case Nike and Operation PUSH in the second edition of this book. Nike had also come under attack for promoting its shoes in the inner city, and activists alleged that children were spending large sums to have the latest styles of shoes. A journalist wrote a sensational story of an inner city youth who killed another youth for a pair of basketball shoes. It was subsequently revealed that the journalist had fabricated the story.

Nike also adopted a series of measures to address the substance of the issues. It developed a code of conduct for its suppliers. It hired Ernst & Young to audit the working conditions in its suppliers’ factories, but results of the audits were not made public as activists had developed. As a result of the audits Nike took a number of steps, including canceling contracts with four factories in Indonesia. Factory supervisors responsible for the abuse of workers were promptly fired. Nike also established a Labor Practices Department to monitor and improve conditions. (Nike personnel are generally assigned to suppliers’ factories to monitor the quality of goods produced, so it was not ignorant of the conditions under which its shoes were produced.) However, revelations of incidents such as at the Vietnam factory, the withholding of wage increases in Indonesia, and the leaking of an Ernst & Young report about hazardous levels of chemicals at a factory overshadowed the steps Nike was taking. Nike’s hiring of Andrew Young to inspect suppliers’ factories and make recommendations for improvements, and Nike’s pledge to follow through on those recommendations, seemed to fuel rather than quench the flames of criticism.

### **Teaching the case:**

The basic approach to teaching the case is to utilize the frameworks in Chapter 4 and the earlier chapters. Figure 4-1 can be used to assess how good a target Nike is and how effective a boycott is likely to be. The framework in Figure 4-2 can be used to characterize and analyze the strategy of the activists in their efforts to advance these issues. The theory of the new media can be used to assess how extensively these issues will be covered and the treatment they are likely to receive. The nonmarket life cycle can be used to assess the development of these issues and to assess where Nike was in dealing with the issues. The final part of the discussion can focus on what Nike should do to resolve these issues and whether it should change its market strategy. For example, should it negotiate with the activists and labor unions? Should it make substantial changes in its practices, and if so, what should it do?

**Discussion questions:**

1. Are the allegations against Nike serious? On moral grounds? On other grounds?
1. What are the motivations of Nike's critics?
2. What role has the news media played in the development of these issues and their progress through their nonmarket life cycle? How much coverage are these issues and events likely to receive and why? What kind of treatment will the news media give them?
3. Are these issues largely in the realm of public relations as Knight suggests at the end of the case?
4. Are these issues likely to affect Nike's sales? Is Nike susceptible to a boycott? Is a boycott likely to be effective?
5. Has Nike dealt effectively with these issues?
6. What should Nike have done? At what stages of their life cycles should Nike have addressed these issues?
7. Should Nike negotiate with its critics?
8. Should it make public the results of the Ernst & Young audits?
9. Should Nike open its suppliers' factories to independent inspections by non-governmental organizations?
10. Should Nike own the factories that produce its products, so as to have better control over the working conditions? Should it change its market strategy?
11. How should Nike resolve these issues?
12. Suppose President Clinton asked Nike to join with other companies, activists, labor unions, and others to develop a voluntary set of standards for the working conditions in suppliers' facilities. Should Nike participate knowing that the activists and labor unions would push hard for a living wage and for U.S. health and safety standards?
13. If it accepts President Clinton's invitation, what approach should it take in the group's deliberations?

**Developments:**

Nike accepted President Clinton's invitation, and the group, known as the Apparel Industry Partnership (AIP), worked and battled for two years before finally reaching an agreement in 1998 on a code of conduct for the working conditions in suppliers' facilities. This is discussed in Chapter 24 and will not be discussed in detail here other than to note that the code did not include a provision requiring a living wage. The Union of Needletrades, Industrial and Textile workers resigned from the AIP in protest over not including a living wage requirement in the code. The



AFL-CIO and the Retail, Wholesale and Department Store Union, which were not part of the AIP, also rejected the agreement. The AIP agreement called only for the Department of Labor to conduct a study on the issue of a living wage. Nike pledged to follow the code.

Participants in the AIP established the Fair Labor Association (FLA) to provide independent monitoring and reporting of working conditions in suppliers' factories. In response to protests by college students over the working conditions in factories producing their school's licensed merchandise, the FLA allowed colleges and universities to affiliate with it and added one seat to its board to be selected by the affiliated schools. The FLA also established a College/University Advisory Council. The FLA has evolved since its founding, and information on the FLA can be found at [www.fairlabor.org](http://www.fairlabor.org) and in Chapter 24.

In 1998 Nike changed its approach to the issues. It voluntarily announced a policy at the National Press Club that its suppliers would not hire anyone under the age of 18 in its footwear plants and 16 in its apparel plants. (In contrast, Levi Strauss & Co. allows its contractors to employ children as young as 14 if that is permitted by the law.) Knight also announced that it would require all shoe factories to monitor air quality for chemicals and to meet U.S. standards. (This issue had been identified by Ernst & Young in its audits.) Knight said that he wanted to eliminate "the cloud that has been over Nike's head." "The Nike product has become synonymous with slave wages, forced overtime and arbitrary abuse. I truly believe the American consumer doesn't want to buy products made under abusive conditions."<sup>43</sup>

Nike was also affected by the worldwide campaign of environmental activists to eliminate the use of polyvinyl chloride (PVC). In August 1998 it announced it would end the use of PVCs in the production of its shoes, although it would take some time to find a replacement. Greenpeace heralded Nike's decision.

By the early 2000s Nike was considered the leader in working to implement high standards in its suppliers' factories. See Chapter 24.

In the quarter ending May 31, 1998, Nike reported its first quarterly loss in 13 years. The loss was due to a \$130 million restructuring charge and to a sharp decline in sales in Asia and particularly Japan as a result of the Asian economic crisis. How much the boycott hurt Nike is not known.

In an important case with potential widespread implications in 2002, the Supreme Court of California ruled in a 4-3 decision that Nike could be tried for allegations of fraud because its speech discussing its working practices in overseas factories was commercial speech and hence not given the full protection of the First Amendment. An individual had filed a lawsuit alleging that Nike's statements about its practices were fraudulent. Nike argued that its speech was protected by the First Amendment and appealed through the California courts. The majority wrote, "Because the messages in question were directed by a commercial speaker to a commercial audience, and because they made representations of fact about the speaker's own business operations for the purpose of promoting sales of its products, we conclude that these messages are commercial speech

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<sup>43</sup> *New York Times*, May 13, 1998.

for the purposes of applying state laws barring false and misleading commercial messages.”<sup>44</sup> The court did not rule on the merits of the case but instead was only concerned with whether the case could go to trial. The decision of the majority went so far as to write that a statement could be viewed as commercial speech even when mixed with statements about noncommercial subjects. In a dissenting opinion Justice Ming Chin wrote, “While Nike’s critics have taken full advantage of their right to ‘uninhibited, robust, and wide open’ debate, the same cannot be said of Nike.” If this ruling were to stand, it could have a profound effect on companies’ communication with the public on nonmarket issues. As an indication of the potential importance of the case, Nike’s side was supported in a brief by the American Civil Liberties Union as well as the Chamber of Commerce, whereas the plaintiff’s side was supported by briefs from the California attorney general, the Sierra Club, and the state AFL-CIO.

This case was settled out of court.

In July 2011 new allegations of worker abuse (similar to those in the case) arose at Nike owned plants in Indonesia. Nike reported that two-thirds of the 168 factories making Converse sneakers failed to meet Nike’s standards. Nike, however, said it was powerless to do anything about the conditions because the factories operated under contracts in force before it bought Converse.<sup>[1]</sup>

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[1] *San Jose Mercury News*, July 14, 2011.

## **The Anatomy of an Activist Campaign: Rainforest Action Network and Citigroup**

The purpose of this case is to consider an activist challenge to a firm and the firm’s nonmarket strategies for dealing with the challenge. A companion case, *Strategic Activism: The Rainforest Action Network*, is available from the Stanford Business School and from the Harvard Business School case services. This case describes the organization and strategy of RAN.

The (A) and (B) cases can be used for a group negotiation exercise. One group can assume the role of Citigroup and the other RAN. The assignment would be open-ended of the form: Citigroup calls RAN just before the annual meeting, asks for a truce, and expresses a willingness to negotiate. Or the assignment could be given more structure by giving the group instructions to address specific issues such as those identified in the (A) (B) and (C) cases. The (A) and (B) cases could also be used for an in-class role-playing exercise.

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<sup>44</sup> *New York Times*, May 3, 2002.

The (A) and (B) cases can be discussed together or sequentially. The following questions can be used in leading a discussion of the (A) case.

The following are three exhibits that may be distributed with the (A) case. (Copyright © 2004 by the Board of Trustees of the Leland Stanford Junior University. All rights reserved. Reprinted with permission. ) Following the three exhibits for the (A) case are two exhibits for the (B) case. (Copyright (C) 2004 by the Board of Trustees of the Leland Stanford Junior University. All rights reserved. Reprinted with permission.)

**Exhibit 1**  
**RAN's Introductory Letter to Citigroup**

April 10, 2000

Dear \_\_\_\_\_ :

As one of the world's largest and most dynamic financial institutions, the influence of Citigroup on the global environment and communities is tremendous. Because the private financial industry has such a pervasive global reach, Citigroup has an unprecedented ability to influence all the sectors of the economy. Our civilization is at an urgent juncture and Citigroup may choose to drive the world further down the path of environmental devastation and social breakdown or set a new course toward a healthy and equitable world for our children.

Research into a multitude of environmentally and socially destructive projects and financial activities around the globe has repeatedly revealed Citigroup's involvement. Fierce addiction to fossil fuels continues to pollute our atmosphere and alter the climate of the Earth alarmingly. Our primary forests dwindle as mining, oil exploration, and the archaic use of ancient trees for construction materials decimate a global treasure. Hydropower technology that we no longer accept in our own country is enthusiastically exported to developing nations. The impacts of this behavior are well known: extinction of species; entire ecosystems damaged; poverty and starvation around the world.

To demonstrate true integrity in leadership, the individuals of Citigroup must immediately embody the values of a democratic society. Citigroup people must achieve environmental and social progress throughout all aspects of their business. For example: Citigroup will have to extract itself from unsustainable investments in fossil fuels to move its capital support into renewable energy; they will have to cease funding destruction of primary

forests for timber or mining or oil exploration and transition that support to alternative building supplies and paper materials; every financial decision must exhibit a larger commitment to basic human rights and modern environmental values.

The recent outcry against financial and trade institutions demonstrates the level of public dissatisfaction with current standards of commitment to environmental and social concerns. Even the so-called best practices standards (e.g., the World Bank's) are blatantly ineffectual. The onus lies with you as the industry leader of the largest economy in the world to pioneer a new model for commerce. A new economic ethic has emerged and it is clear that the public will no longer tolerate the status quo.

Sincerely,

Kelly Quirke  
Executive Director

**Exhibit 2**  
**Graphic from Ad Printed in *Wired Magazine*, May 2000**



The graphic was also passed out as a postcard at Citigroup's shareholder meeting, with the following text on the back:

## **CITIGROUP**

### What's your bottom line?

Environmental devastation and social breakdown OR a healthy and equitable world for our children?

*Here is what the lending, trading, and financing activities of America's bank buys us:*

- ◆ In partnership with Maxxam Corp destroying California's last remaining redwood forests
- ◆ Mining of the Amazon rainforest
- ◆ Production of genetically engineered trees to feed pulp mills in Chile
- ◆ Destruction of critical orangutan habitat in Indonesia
- ◆ Displacement of a million people from their homes to build the Three Gorges Dam in China.
- ◆ Exploitation of the Gobe oil fields of Papua New Guinea
- ◆ Profit from unjust community lending practices that keep poverty permanent
- ◆ Funding unwanted destructive development of the third world
- ◆ Holding and selling World Bank bonds

It's past the time for a fundamental change. A new economy is emerging and Citigroup must take the lead to steer the industry in the right direction.

**[www.ran.org](http://www.ran.org)**

**Exhibit 2 (continued)**  
**Ad Printed in *Mother Jones*, December 2000**



## You just bought your family a clearcut...

Probably not the nest egg you planned for.

**BUT THAT'S WHAT YOU GET WHEN YOU BANK WITH CITIGROUP.** Citi uses your money to finance rainforest destruction, global warming, and exploitation of indigenous lands, for starters. Behind bad projects are bad financial decisions. As the biggest bank in the US, Citi is a top player in setting global economic strategy. And yet Citi has virtually NO policies to integrate ecological and

social concerns into its economic decision-making. Can our country's #1 bank in fact make a change for the better? That's what the planet needs, and you can help. Start by cutting up your Citi credit card and sending it back to them with a note explaining why. Then go to [www.ran.org](http://www.ran.org) for more information.



415.398.4404 [www.ran.org](http://www.ran.org)

### **Teaching the case:**

RAN chose Citigroup as the first target in its global finance campaign not only because it was the industry leader and the worst offender but also because it had large consumer banking and credit card businesses that could be harmed by a campaign.

What leverage does RAN have over Citigroup?

If they respond “yes,” ask if they have leverage against all the project finance banks.

If Citigroup refuses to participate in the financing of a project, will it be easy to find replacement financing? Will that replacement financing be more costly?

As Citigroup can these standards impair your relations with host country governments where you hope to operate? That is, a government wants a project financed, but Citigroup either refuses to participate in financing it or requires costly changes in the project if it is to provide funding.

RAN wants to bargain/negotiate with Citigroup. How does it tell the difference between bargaining and discussions?

The case mentions “democracy in the marketplace.” Is that what is going on? That is, is RAN bringing democracy to the marketplace?

After Citigroup received the letter from RAN, can it begin to work with a less aggressive environmental group and have RAN back off? To answer this, first ask if the other environmental group is likely to be willing to work with Citigroup knowing it has been targeted by RAN. The answer may be “perhaps not.” Even if a group were willing to collaborate with Citigroup on this issue, that is unlikely to deter RAN because it sets very aggressive or extreme objectives which may not be shared by the other environmental group. (For example, in its campaign against Ford RAN set the objective of getting Ford to achieve 50 mpg by 2010, whereas more moderate groups like the Sierra Club, which had also targeted Ford, had set a goal of 40 mpg. RAN deliberately chose 50 mpg because it was the maximum of what activists believed might be achievable with currently available technology.) Given the RAN was unlikely to back off and other environmental groups understood that, finding another group with which to work would not solve Citigroup’s problem. As indicated in the (C) case below, Citigroup joined with three other banks to address the environmental issues associated with project finance. This did not deter RAN.

RAN engages in civil disobedience. This frequently involves violating laws and usually those laws are just and legitimate. Is it acceptable to break laws, such as trespass, in conducting their campaign?

With regard to legal actions, are its claims in its letter to Citigroup and its advertisements truthful, distorted, irresponsible, etc.?

Is RAN correct in its assertions? Does it matter?

**Discussion questions:**

1. It is the spring of 2000 and you (Citigroup) receive a vague letter from RAN and Ran speaks at your annual meeting. What is it that RAN really wants?
2. Why didn't RAN target the project companies; i.e., the construction companies, the oil companies, the mining companies?
3. Why did RAN think Citigroup was a good target? Isn't Citigroup the largest, most-profitable, and perhaps the most powerful bank in the world?
4. If Citigroup stopped financing these projects, would not some other bank step in and provide the financing?
5. What harm can this campaign do to Citigroup?
6. Will the campaign attract much media coverage?
7. How will RAN try to get leverage on Citigroup? Will it work?
8. Should Citigroup wait them out? Stall?
9. Should Citigroup negotiate with them?
10. If Citigroup did what RAN has demanded, will it be rewarded in the marketplace? Why didn't RAN offer a carrot rather than a stick?
11. If Citigroup were to negotiate an agreement with RAN, would it want its competitors to also reach the same agreement with RAN?
12. Is this introducing democracy into the marketplace?
13. Is this non-violent civil disobedience or is it coercion and intimidation?

**RAN and Citigroup (B)**

Citigroup has been weakened by scandals and lost more than a quarter of its market value in two days. This and Weill's desire to leave a legacy may have provided RAN with the opportunity for success.

RAN's objective of stopping destructive projects may be worthy, but are the tactics employed in its campaigns acceptable? Is it acceptable for RAN to break laws such as trespass?

Taking the role of RAN, you are about to mount a protest at the Citigroup 2003 annual meeting and you receive a call from Citigroup proposing a truce. Do you agree? Under what conditions?

Do you say no unless something tangible is done to show good faith; e.g., promise to negotiate? Announce publicly that you will stop financing a pipeline project in South America?

In the negotiations will you seek to write an enforceable contract with Citigroup? As Citigroup would you agree to an enforceable contract? How close to enforceability are you willing to go? A policy approved by the Board of Directors?

What kind of agreement would you as RAN accept?

What dimensions/items would you like covered?

What standards would be acceptable?

What monitoring and enforcement arrangements would you accept? Suppose Citigroup pledged to report on the projects it financed in its Social Responsibility report. Would that be sufficient?

How can RAN enforce an agreement with Citigroup?



Can RAN rely on reports from local groups in the project countries?

What is it that RAN wants the public to do in its campaign?

In the *Shell, Greenpeace, and Brent Spar* case switching costs were very low—just drive to a service station of another oil company. In the case of Citigroup the switching costs of changing an account from Citibank to another bank are fairly high in terms of a person's time. In the case of a person setting up an account for the first time, the switching costs are low since banks are fairly close substitutes. The switching costs associated with a credit card are quite low. For someone with multiple cards all that is needed is scissors. For someone with only one card, if there is such a person, the costs are somewhat higher because it would be necessary to apply for another card.

**Wrap-up questions:**

1. Would the banks have adopted these policies in the absence of pressure?
2. Would public politics have resulted in such an outcome? If so, how long would it have taken?
3. Would moral suasion have resulted in this outcome? How would they have gotten Citigroup's attention?
4. If neither of these is likely to lead to change, will activists increasingly turn to private politics?
5. Will the public support these groups? Financially? With participation?

**RAN and Citigroup (C):**

As a result of the Enron and WorldCom scandals, Citigroup's reputation was damaged. The new CEO Chuck Prince pledged to repair the damage and prevent further damage. As indicated below, this was only partly successful. Alan Murray, writing in the *Wall Street Journal*, explained the responsiveness of the large banks to RAN's global finance campaign: "the real secret of RAN's success is that the big banks have neither the courage nor the credibility to stand up to the group. That is the price paid for three years of scandal."<sup>45</sup>

Bargaining with activists can be hampered by language and hostility barriers, since a firm may have difficulty understanding the activist and its demands. To help it understand RAN and facilitate its discussions, Citigroup hired a former Greenpeace member who had subsequently earned an MBA. (Similarly, Weyerhaeuser hired a facilitator to help in its discussions with RAN.)

Once Citigroup and RAN have reached an agreement, should Citigroup expect any further demands from RAN? Is so, what are those demands likely to be? RAN said that it has additional demands, and Citigroup knows that they would follow. The first is for Citigroup to stop financing companies that engage in illegal logging, particularly in Southeast Asia. There is a question of what qualifies as "illegal" logging. One obvious candidate is logging that does not have the explicit approval of the property owner, if there is one, or the government. Governments can easily be corrupted, however, so a logging operation that has a government permit could still be deemed illegal in RAN's view. The companies doing the illegal logging in Southeast Asia are primarily Asian companies, and RAN has difficulty getting any traction against them. Cutting off funding is one possible way to put some pressure on them.

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<sup>45</sup> *Wall Street Journal*, April 13, 2005. RAN had begun its campaign two years before the scandals became public.

Can RAN really be successful if some other bank steps in and provides the financing of the projects? RAN has targeted the principal U.S. banks and may be able to get them to agree to principles similar to Citigroup's. It will be much more difficult, however, to target Asian banks. At a minimum RAN's success with the U.S. banks will raise slightly the cost of financing for the projects. This means that for success RAN wants to get all project finance banks to impose environmental standards in their project finance.

### **Developments:**

In the Citigroup campaign RAN consulted with, but did not join, other groups, including the World Wildlife Forum, Friends of the Earth, Trillian Asset Management, and CERES, that were concerned about project finance. RAN differed from these groups in that its demands were more aggressive and in that it told Citigroup what its policy should be. In the end RAN did not achieve everything it had demanded.

Brune and Hogue negotiated for 8 months with Citigroup. RAN was unable to get its full set of demands and had to compromise somewhat on the matter of sustainable energy policy. It did achieve its demands on forest protection. RAN told Prince that Citigroup was far from supporting only sustainable activities. In the negotiations Randy Hayes was involved and Brune sent the first draft of Citigroup's policy and the final agreement to the entire board, but the intermediate drafts were sent to only three or four board members for their thoughts. The Citigroup board did not approve the policy, and Brune did not know whether it had been discussed at the board level.

In April 2004 RAN met with CEO Chuck Prince to discuss implementation of their new policy. They agreed to meet quarterly to discuss progress and to report formally annually. In addition to the implementation RAN and Citigroup reached a "no surprises" agreement. Citigroup agreed to notify RAN if they planned to violate its policy, and RAN agreed to give Citigroup warning if it was planning to criticize Citigroup. Brune said that Citigroup, along with Kinko's, Home Depot, and Lowe's were the best in terms of their commitments.

Prince had earlier offered to call Chase and BOA to urge them to follow its lead on an environmental policy. He made the calls. He certainly had an incentive to call, since Citigroup may have been at a disadvantage competitively in project finance.

Citigroup understood that RAN might make future demands. The next demand could be that Citigroup stop financing Asian companies that are doing illegal logging in Southeast Asia.

RAN gave "the liquidators" a deadline of April 22, 2004 for a draft policy. I visited RAN that day, and Brune stated that the Fed Ex packages were pouring in. Every bank sent a draft policy. In addition, Brune had an email from Chase asking for comments on its draft. Brune commented that the ones he had looked at were not very good.

The Equator Principles are a major accomplishment. The Equator Principles are discussed in Chapter 24.

Michael Brune left RAN in 2010 to become executive director of the Sierra Club, the largest membership based environmental NGO in the United States.

### **The Next Steps in the Global Finance Campaign**

After concluding the campaign targeting Citigroup RAN turned its attention to Bank of America and JP Morgan Chase. The letter to Bank of America is included below as an exhibit in the *Anatomy of a Corporate Campaign: Rainforest Action Network and Citigroup (C)*. Bank of America quickly told RAN that it would go further than Citigroup had, and within a month or so it issued its new environmental policy. RAN was pleased and hailed it as another victory.

JP Morgan Chase did not act, however, and RAN launched a campaign similar to the Citigroup campaign, including a Day of Action on April 11, 2005. Shortly thereafter JP Morgan Chase issued a new environmental policy that went beyond Citigroup and Bank of America. RAN praised JP Morgan Chase and hailed it as another victory.

After the JP Morgan Chase victory, RAN wrote on its Web site, “Meanwhile investments of mass destruction are still being produced by other global financial institutions.” RAN listed the logos of the remaining Liquidators: Credit Suisse/First Boston, Goldman Sachs, Merrill Lynch, Morgan Stanley, Wachovia, and Wells Fargo.

The following are two figures from the (B) case.

**Exhibit 1**  
**Ad Printed in *The New York Times*, November 2002**



Did you know  
that someone is  
using your Citigroup  
credit card without  
your authorization?

Citigroup is using your money to fund environmental destruction around the world.



Sandy Weill  
Chairman and CEO,  
Citigroup, Inc.

Citigroup is an ethically bankrupt company that cannot be trusted with your money. It is the leading financier of environmentally and socially destructive logging, mining, and fossil fuel projects around the world. Citigroup uses your dollars to profit off projects that destroy endangered forests, displace local communities, and accelerate global warming.

The red umbrella is behind the chainsaws and bulldozers that are destroying ancient redwoods in California's Headwaters Forest, rainforests in the Peruvian Amazon surrounding the Camisea gas project, endangered orangutan habitat

in Indonesia, and the Mindo Nambillo cloudforest in Ecuador, among others.

It's time for Citigroup CEO Sandy Weill to follow the lead of top European banks such as ABN AMRO and establish meaningful environmental and social criteria to evaluate the projects Citigroup funds. Cut up your Citi card today and tell Sandy Weill "Not with My Money" until he meets the financial industry's best practices. Because the last thing you want is an unethical bank wreaking global havoc. Especially with your credit card.



**Exhibit 2**  
**Picture of the “Wanted” Poster of Sandy Weill**



## **ANATOMY OF A CORPORATE CAMPAIGN: RAINFOREST ACTION NETWORK AND CITIGROUP (C)**

Ilyse Hogue, campaign manager for the Global Finance Campaign, said that RAN started gaining traction with Citigroup when the stars aligned in the summer of 2002—Citibank was vulnerable from the criticism resulting from the Enron and Grubman scandals, and RAN had reached its height of effectiveness (the activist base was educated and aware). RAN took advantage of the situation and increased the pressure in the Global Finance Campaign. By the spring of 2003, action at universities had increased, particularly at Columbia, and the campaign became personal as activists canvassed Citigroup CEO Sandy Weill's hometown. Adding to Citigroup's vulnerability, Weill was on the verge of retiring from the CEO position. RAN believed that the attention generated by its campaign could jeopardize Weill's legacy and reputation.

### **NEGOTIATIONS**

RAN planned protests at Citigroup's April 15, 2003 annual meeting, marking the three-year anniversary of its initial challenge to Citigroup. Citigroup knew that RAN was planning protests.<sup>46</sup> Hours before the annual meeting, Citigroup asked RAN for a cease-fire—during which RAN would stop campaign activities and Citigroup would start negotiating. RAN agreed to a three-month cease-fire.

During the cease-fire, negotiations started with a joint review by Citigroup and RAN of various policies and best practices to protect against ecosystem destruction. Input from Citigroup's clients and investors was also taken into consideration. Citigroup's vice president of community relations had become very knowledgeable about environmental issues and become more involved in the day-to-day negotiations with RAN. By July RAN reported that progress had been made regarding forest protection, global warming, and the rights of indigenous people. RAN extended the cease-fire for another 45 days, giving Citigroup more time to develop a policy.<sup>47</sup>

### **THE EQUATOR PRINCIPLES—A STEP FORWARD OR A BLOW TO RAN?**

In June in the midst of the Citigroup-RAN cease-fire, 10 banks, including Citigroup, voluntarily adopted the Equator Principles (EPs). The EPs were developed by the World Bank's International Finance Corporation (IFC) and established environmental and social impact standards applicable to project finance. (The IFC had had safeguard policies in place for many years but had only recently worked with private banks to develop the EPs.) The banks participating in the EPs provided \$9.1 billion in funds for infrastructure projects in 2002.<sup>48</sup>

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<sup>46</sup> In addition to outside protests, two shareholder resolutions were on the ballot. One asked Citigroup to set industry best practices in the area of environmental and social responsibility, and the other asked Citigroup to audit its investments in all greenhouse gas producing industries and commit to reduce that exposure over time.

<sup>47</sup> "Rainforest Action Network Statement on Citi Negotiations," RAN press release, July 15, 2003.

<sup>48</sup> Michael M. Phillips and Mitchell Pacelle, "Banks Accept 'Equator Principles'—Citigroup, Barclays, Others To Shun Projects Hurting Environment, Livelihoods," *The Wall Street Journal*, June 4, 2003.

Non-governmental organizations (NGOs), including RAN, praised the participating banks for taking steps to address the environmental and social problems, but they also said the EPs were inadequate. Hogue said, “We’re glad to see banks responding to pressure that’s been brought on them. But I think that you’ll find broad consensus around the NGO community that the Equator Principles don’t go far enough. The loopholes are wide enough for bulldozers to move through.”<sup>49</sup> Some of the specific criticisms by the NGOs included:<sup>50</sup>

- The NGOs concluded that the EPs, although pointing in the right direction, fell short. For instance, the EPs did not impose any “no-go” zones (or “red lights”) for endangered ecosystems deemed critical.
- The EPs would be monitored by the IFC, but the NGOs believed that the IFC, with only 30 environmental staff, had a poor track record of implementing its policies. For instance, the Oleoducto Crudos Pesados project in Ecuador had been funded although it did not meet IFC standards.
- The EPs had loopholes—projects under \$50 million were not subject to the EPs and projects had to be generally consistent, but not strictly comply, with the EPs.
- The EPs did not include disclosure rules, so there was no way to ensure that banks were actually abiding by the EPs—and if they were not, there was no way to enforce the EPs (especially since compliance with the EPs was voluntary).
- NGOs worried that the EPs, while a step in the right direction, would be seen as sufficient and would actually hinder the adoption of best practices.

#### **CITIGROUP’S NEW ENVIRONMENTAL INITIATIVES**

RAN continued to press Citigroup to go beyond the Equator Principles. Negotiations continued and shortly after the EPs were announced, both RAN and Citigroup drew up initial drafts of a new set of policies.

Hogue said, “RAN and Citigroup did not speak the same language, so we often misunderstood each other.” To help the negotiation process, Citigroup hired Matt Arnold, who had worked at Greenpeace and earned an MBA at Harvard. Although Arnold was originally hired as a contractor to deal with the negotiations, he later helped Citigroup with implementation of the new policies.

On January 22, 2004, following further negotiations (and shortly after Chuck Prince became Citigroup CEO), RAN and Citigroup announced that Citigroup had adopted new environmental initiatives (Appendix I). These initiatives went further than the EPs—for instance, Citigroup’s policy included certain rules to protect “high caution zones”—areas of significant ecological value. These rules, among other things, ensured that projects that would significantly degrade critical natural habitats were not funded (e.g., Citigroup would deny funding for commercial logging in tropical rainforests). In addition to defining and protecting the high caution zones, Citigroup’s initiatives covered illegal logging, investing in ecologically sustainable development (e.g., renewable energy), and climate change. The new initiatives went beyond project finance funding to include general corporate loans where proceeds were directed toward destructive activities or projects.

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<sup>49</sup> Ibid.

<sup>50</sup> “Collective NGO Analysis of the Equator Principles,” [http://www.ran.org/news/equator\\_ngo.html](http://www.ran.org/news/equator_ngo.html), March 8, 2004.

RAN had a policy of publicly thanking its targets when an agreement was reached. Exhibit 1 presents a congratulatory advertisement placed by RAN in *The New York Times*. Other than the threat of restarting its campaign, however, RAN had no hold over Citigroup.

As part of the agreement with RAN, Citigroup pledged to report on the progress on its initiatives in an annual Corporate Citizenship Report, and to report confidential data quarterly to RAN. Citigroup would also report on the greenhouse gas emissions from power projects in its project finance portfolio. In 2002 Citigroup first reported energy usage in the over 10,000 buildings it leased or owned globally.

## **THE LIQUIDATORS**

Although the Global Finance Campaign initially targeted only Citigroup, the goal was to move the entire financial sector. In the spring of 2004, Mike Brune, executive director at RAN, said, “We have a toehold, but the campaign is far from over. We need most of the major world banks to deny funding for a whole class of projects—whether to protect mangrove forests or prevent against over-fishing or irresponsible energy production.”

On January 23, 2004, RAN wrote to 10 other U.S. banks, which RAN dubbed “The Liquidators,” for “liquidating the Earth’s most valuable natural assets to post short-term profits at a long-term cost to the world.”<sup>51</sup> The Liquidators were JPMorgan Chase, Bank One, Bank of America, Fleet Boston Financial, Wells Fargo, Goldman Sachs, John Hancock, Wachovia, U.S. Bancorp, and SunTrust. RAN challenged The Liquidators to “meet or beat” Citigroup’s policies. Not all of The Liquidators had Citigroup’s consumer presence, so it was unclear if RAN would find success using the same tactics it had used against Citigroup. Pursuing The Liquidators would also consume a portion of RAN’s limited resources.

The initial focus was on two banks, Bank of America and JPMorgan Chase, both of which had pending mergers. The first sentence of the letters from RAN to them read, “Congratulations on your pending merger...” (See Exhibit 2 for the letter to Bank of America.)

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SOURCE: Research Associate Erin Yurday, Cornell MBA 1998, prepared this case under the supervision of David P. Baron. This case would not have been possible without the help of Mike Brune and Ilyse Hogue of Rainforest Action Network. Copyright © 2004 by the Board of Trustees of the Leland Stanford Junior University. All rights reserved. Reprinted with permission.

## **PREPARATION QUESTIONS**

1. Should Citigroup have adopted its new policy? How should it implement that policy?
2. How should RAN enforce and monitor Citigroup’s compliance? Is Citigroup’s reporting pledge adequate?
3. Should Citigroup be prepared to expect RAN to make further demands?

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<sup>51</sup> “RAN Dubs Destructive Lenders: ‘The Liquidators,’” RAN press release, January 23, 2004.



4. Should RAN attempt to establish a regular forum for meeting with Citigroup to monitor compliance? If RAN makes such a request, should Citigroup agree to it?
5. What strategy should RAN use to obtain agreements with The Liquidators?
6. How should The Liquidators respond, if at all, to RAN's challenge? How should Bank of America and JPMorgan Chase respond to RAN's letters?

## Appendix I Citigroup's New Environmental Initiatives<sup>52</sup>

### Introduction

Protecting natural systems while lifting two billion people out of poverty and advancing economic development are the world's greatest challenges. These three foundations of sustainable development are central to the UN Millennium Goals, to national governments, to companies and to civil society. Citigroup has a broad array of policies and programs addressing environment, poverty and the economy. In 2004 we announced a new set of policies and programs focused on sustainable development.

### New Initiatives

#### 1. High Caution Zones

Consistent with its responsibilities under and the requirements of the Equator Principles and led by its project finance business, Citigroup will carefully evaluate requests for project finance loans where the borrower's proposed use of proceeds would directly fund activities that Citigroup determines could adversely impact a critical natural habitat.<sup>53</sup>

Citigroup will ensure that the appropriate Citigroup bankers throughout the world are aware of and alert to this new Equator-based approach. Citigroup will periodically engage with various stakeholders and evaluate its experience with these policies in a year with stakeholders and report annually in our Corporate Citizenship Report. Citigroup will not finance any project or provide general corporate loans to any project (where the use of proceeds is known) if the project or use of proceeds is located within critical natural habitats, unless the sponsor or borrower, as appropriate, has demonstrated to Citigroup's satisfaction:

- The project sponsors have considered economic and technically feasible alternatives to avoid such areas and have addressed these issues in the publicly available EA;
- The project will not significantly degrade<sup>54</sup> or convert<sup>55</sup> the critical natural habitat;

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<sup>52</sup> [www.ran.org](http://www.ran.org).

<sup>53</sup> Critical natural habitats are:

(i) existing protected areas and areas officially proposed by governments as protected areas (e.g., reserves that meet the criteria of the World Conservation Union [IUCN] classifications), areas initially recognized as protected by traditional local communities (e.g., sacred groves), and sites that maintain conditions vital for the viability of these protected areas (as determined by the environmental assessment process); or

(ii) sites identified on supplementary lists prepared by the World Bank or an authoritative source determined by IFC's Environment and Social Development Department. Such sites may include areas recognized by traditional local communities (e.g., sacred groves); areas with known high suitability for biodiversity conservation; and sites that are critical for rare, vulnerable, migratory, or endangered species. Listings are based on systematic evaluations of such factors as species richness; the degree of endemism, rarity, and vulnerability of component species; representativeness; and integrity of ecosystem processes.

<sup>54</sup> Degradation is modification of a critical or other natural habitat that substantially reduces the habitat's ability to maintain viable populations of its native species.

<sup>55</sup> Significant conversion is the elimination or severe diminution of the integrity of a critical or other natural habitat caused by a major, long-term change in land or water use. Significant conversion may include, for example, land clearing; replacement of natural vegetation (e.g., by crops or tree plantations); permanent flooding (e.g., by a reservoir); drainage, dredging, filling, or channelization of wetlands; or surface mining. In both terrestrial and aquatic ecosystems,

## **Appendix I (continued)**

### **Citigroup's New Environmental Initiatives**

- Project management has adequate capacity and willingness to ensure biodiversity protection and respect for the rights of indigenous communities whose livelihoods or cultural integrity could be adversely impacted;
- Indigenous peoples<sup>56</sup> impacted by the project, whether directly or by induced impact, have the opportunity and if needed, culturally appropriate representation, and have access to the information to engage in informed participation;
- The governmental authorities at the local, regional or national level have provided mechanisms for the affected communities to be represented or consulted, and international and local laws have been upheld<sup>57</sup>; and
- An Environmental Impact Assessment has been prepared that takes into account such consultations and is publicly available.

#### Categorical Exclusions

In accordance with the Equator Principles, Citigroup will follow International Finance Corporation Safeguards in effect at the time Citigroup becomes engaged in a project, including the following:

- Citigroup will not finance commercial logging operations or the purchase of logging equipment for use in primary<sup>58</sup> tropical moist forest<sup>59</sup>.
- Citigroup will finance only preservation and light, nonextractive use of forest resources in forest areas of high ecological value.
- Citigroup will finance plantations only on nonforested areas (including previously planted areas) or on heavily degraded forestland.
- Citigroup will not finance projects that contravene any relevant international environmental agreement which has been enacted into the law of, or otherwise has the force of law in, the country in which the project is located.

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conversion of natural habitats can occur as the result of severe pollution. Conversion can result directly from the action of a project or through an indirect mechanism (e.g., through induced settlement along a road).

<sup>56</sup> In financing projects, consistent with the Equator Principles, Citigroup will respect the IFC Indigenous Peoples Safeguard Policy that states: "The Bank's policy is that the strategy for addressing the issues pertaining to indigenous people must be based on the informed participation of the indigenous people themselves. For an investment project that affects indigenous peoples, the borrower should prepare an indigenous peoples development plan that is consistent with the Bank's policy. Any project that affects indigenous peoples is expected to include components or provisions that incorporate such a plan."

<sup>57</sup> Including those laws related to the ratification and implementation of "Convention 169 Concerning Indigenous & Tribal Peoples in Independent Countries" of the ILO.

<sup>58</sup> Primary forest is defined as relatively intact forest that has been essentially unmodified by human activity for the previous 60 to 80 years.

<sup>59</sup> Tropical moist forest is generally defined as forest in areas that receive not less than 100 mm of rain in any month for two out of three years and have an annual mean temperature of 24° C or higher. Also included in this category, however, are some forests (especially in Africa) where dry periods are longer, but high cloud cover causes reduced evapotranspiration.

## **Appendix I (continued)**

### **Citigroup's New Environmental Initiatives**

#### 2. Illegal Logging

Citigroup recognizes that illegal logging is increasingly a threat to forests worldwide. We appreciate that forests provide humanity with precious natural resources. As expressed in numerous international forums including the G8, The UN Forum on Forests and the World Summit on Sustainable Development, illegal logging is a significant contributor to the degradation and loss of critical forest ecosystems in many regions around the world. Citigroup recognizes the menace to valued ecosystems and forest community livelihoods posed by illegal logging. We recognize that violations of logging laws around the world can have irreparable damage in fragile forest ecological networks where such illegal activity occurs.

Illegal logging causes a number of adverse environmental, economic, and political or social impacts such as depriving national and local governments of related tax revenue, as well as forest owners and local communities of significant revenues and benefits, and acts as a disincentive to sustainable logging. In some countries the corruption associated with illegal logging undermines the rule of law. As evidenced by recently enacted United Nations Security Council sanctions, illegal logging has been associated with civil wars and, is considered a conflict commodity in various battle zones, funding and sustaining violent upheavals.

In this context Citigroup understands illegal logging to take place where timber is harvested in violation of local and national laws intended to stop illegal logging.<sup>60</sup> Illegal logging includes: a) using corrupt means to gain access to forests, b) extraction without permission or from a legally unauthorized area, c) the cutting of protected species or the extraction of timber in excess of legal limits or in violation of legally approved forest management plans.

Consistent with Citigroup's Code of Conduct, all employees of the company and its subsidiaries are expected to act in accordance with the highest standards of personal and professional integrity in all aspects of their employment, and to comply with all applicable laws, regulations and company policies. As such, we will not make loans to companies whom we know to be in violation of local or national laws regarding illegal logging. Citigroup is committed to contributing to the fight against illegal logging and preventing the flow of funds to illegal logging actors. This battle presents new challenges. Successful participation in this fight requires global cooperation by governments, the private sector and civil society.

Citigroup will pursue four policies and programs regarding illegal logging:

Request Citigroup customers seeking loans related to the extraction or processing of forest resources to make appropriate representations regarding compliance with applicable law. This means that a customer will represent to Citigroup that it will comply with all applicable laws including national and local laws regarding illegal logging. Representation in this context is a binding and documented assurance which, if false, could constitute an event of default.

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<sup>60</sup> Illegal logging has not yet been written into international law, although issues relating to illegal logging have been addressed in some fashion by international treaties such as the Convention on Biological Diversity.

Documentation includes all of the documents required to secure a loan including government authorization as necessary.

## **Appendix I (continued)**

### **Citigroup's New Environmental Initiatives**

□□ Take the following steps to combat illegal logging as appropriate 1) engage government and industry forums on trade and governance, 2) participate in on-going forums on illegal logging, and 3) support civil society organizations to advocate for forest law enforcement and policy reform.

□□ Ensure that our businesses and risk management throughout the world are aware of and alert to the issue of illegal logging.<sup>61</sup>

□□ Deepen our collaboration with knowledgeable stakeholders to strengthen our collective efforts to help prevent illegal logging. Better information on the extent of the problem is a prerequisite to developing practical and effective countermeasures.

### 3. Investing in Ecologically Sustainable Development

Citigroup has developed a program to invest in sustainable forestry and renewable energy. Citigroup has identified experienced resources to screen and evaluate potential investments in the sustainable forestry and renewable energy industries to ensure that investment opportunities in these two sectors get exposure and an evaluation consistent with all other investments on an ongoing basis.

We see immediate opportunities in three areas:

- A. Investments in independently certified sustainable logging – Citigroup is evaluating specific investment funds dedicated to FSC certified forest products located in emerging markets. Portfolio companies in these funds are committed to low impact logging, maintaining ecosystem function in the forest lands, and marketing branded sustainable product. Their financial success will protect more forests and employ more local people in sustainable commerce. Citigroup will have the capacity to evaluate these investments on an ongoing basis.
- B. Investments in renewable energy – Citigroup will identify experts to evaluate investment funds dedicated to renewable energy technologies such as wind, solar, hydrogen, biomass etc. Investments in these companies reduce the environmental footprint of the energy sector.
- C. Residential Clean Energy Financing - Citigroup will explore existing programs to offer consumer financing for solar panels, residential wind turbines and fuel cells, and other forms of clean energy or energy efficiency fit for residential consumers. Citigroup will offer and market a Fannie Mae energy efficient mortgage product by the first quarter of 2004.

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<sup>61</sup> A best practice is starting to develop to curtail illegal logging based on the chain of custody verification offered by the Forest Stewardship Council.

**Appendix I (continued)**  
**Citigroup's New Environmental Initiatives**

4. Climate Change

The Intergovernmental Panel on Climate Change (IPCC)-a United Nations panel of 2,000 of the world's top climate scientists-agree that human activities are changing the climate. As a global company, Citigroup is taking a proactive stance on this important issue. Citigroup will play a role in the financial sector to reduce greenhouse gas emissions from its own operations, and assist customers to develop financial solutions that help reduce emissions in the value chain and invest in renewable energy.

Citigroup published its first ever report on energy used in 2002 in the over 10,000 buildings it leases or owns globally. This process has engaged 150 employees, and is building Citigroup's understanding and capacity in greenhouse gas emissions reporting and energy use reduction.

Beyond its own direct emissions, Citigroup will report the greenhouse gas emissions from the power sector projects in its project finance portfolio beginning the latter half of 2003 and going forward. This report will occur annually in the Corporate Citizenship report. This is the first time that a private bank will offer such data, which will be produced with methodologies peer reviewed with experts and NGOs. As reporting methodologies become standardized for other sectors, Citigroup may expand the report.

Finally, the above-mentioned program to identify investments in renewable energy and energy efficiency will help reduce emissions in Citigroup's chain of activities, by adding customers and business partners with an explicit focus on greenhouse gases and energy efficiency.

**Exhibit 1**  
**Ad Printed in *The New York Times*, January 2004**



THANK YOU CITIGROUP  
FOR AN ENVIRONMENTAL  
POLICY THAT HELPS PROTECT  
OUR MOST VALUABLE ASSET.

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WE BELIEVE that today marks the beginning of a new era in the relationship between economy and ecology. Citigroup, the world's financial leader, has adopted an environmental policy that sets a new standard in the financial services industry. "Citigroup and the Environment" introduces progressive policies to protect endangered ecosystems and address climate

change, as well as investment initiatives to promote sustainable forestry and renewable energy. Citigroup's presence in 100 countries makes this one of the most far-reaching environmental commitments to date. With this policy, Citigroup recognizes that our most valuable asset is on loan to us from future generations.





**Exhibit 2**  
**RAN's Letter to Bank of America**

January 22, 2004

Mr. Kenneth D. Lewis  
Chairman and Chief Executive Officer  
Bank of America Corporation  
100 North Tryon Street  
Charlotte, NC 28255

Dear Mr. Lewis,

Congratulations on your pending merger with Fleet Boston Financial.

I am writing to invite you to join Rainforest Action Network in the global effort to preserve the world's last remaining old growth forests and their traditional inhabitants and to confront global warming as one of the most pressing ecological issues of our time. Today, Citigroup, the world's largest financial institution, raised the bar as the world's first major bank to commit to a global policy addressing the crisis in the world's forest and climate. This landmark announcement clearly signals a sea change in how the financial sector commits itself to these challenges. Prohibitions on destructive investments in endangered ecosystems will shift the way the worldviews business as usual. However, our global society cannot fully enact the necessary protections until your company takes decisive action.

According to the World Resources Institute, more than three-quarters of the world's old growth forests have been destroyed or degraded, much within recent decades. The New York Times reported in a January 9 article that leading scientists recently concluded global warming will become the number one cause of species extinction in the next 50 years, affecting up to 37% of species around the world. Private financial institutions over the last decade increased 700% to dwarf public finance as the determinant factor in mega development projects in the developing world. This offers leading banks a unique opportunity to offer solutions that will help to assure the long-term stability of Earth's environment. Bank of America has long been the bank of choice among the top companies in the logging industry, including such notorious players as Sierra Pacific Industries, Asia Pulp and Paper, and International Paper. Bank of America's leading role in the domestic oil and gas industry also indicates a lack of forward thinking driving your business practices.

These issues are all too familiar to an increasingly concerned public. The general public—in overwhelming proportions—is impatient for strong leadership from your industry. According to a 2001 poll in the Los Angeles Times, 9 in 10 Americans favor protection of remaining wilderness areas. This powerful concern for endangered forest protection is manifest in the marketplace, where more than four hundred companies, including many of your clients, are now working to help endangered forests, rather than harm them. According to an April 2003 Gallup Poll, 7 in 10 Americans believe that the effects of global warming have already begun to occur or will occur in their lifetimes.

**Exhibit 2 (continued)**  
**RAN's Letter to Bank of America**

While Bank of America once prided itself on being the environmental leader, we are dismayed by the lack of action your company's has displayed to stay ahead of these critical issues. How many species must be threatened with extinction before your company ends its participation in the destruction of our last endangered forests? How many indigenous communities and forest-dependent people will be marginalized and adversely affected? How many deaths from unpredictable weather are required before we start to reverse the climate crisis? With the world's largest financial institution taking action, how long will Bank of America wait to assume full responsibility for your investments?

We ask that your company take the following steps immediately:

1. phase out all funding and investment for extractive industries (oil, gas, mining, logging) in endangered ecosystems;
2. commit to support the right of indigenous and local populations to have free and prior informed consent to projects on their land;
3. cease funding for all logging projects unless chain of custody certification can prove legality;
4. provide funding for sustainable alternatives, such as Forest Stewardship Council certified logging projects and clean energy sources such as solar and wind power;
5. provide competitive market incentives for consumers to utilize existing opportunities in renewable energy through energy efficient and energy improvement mortgages;
6. document the carbon emissions that are associated with your company's facilities and investments, and commit to reduce those emissions across the company's portfolio over time, in accordance with the prevailing international scientific recommendations of the reductions that are necessary to curb global climate change.

Acting now to address the crises in our forests and our climate will help us build an ecologically sustainable economy in our lifetime. With the pending FleetBoston merger, Bank of America is in a perfect position to seize this opportunity to create a more ecological business model that meets the environmental expectations of your customers. Without prompt attention to incorporate environmental and social policies into your core business, your company will increasingly come under scrutiny and pressure from a global marketplace that demands social and environmental ethics from corporations. If scientific and moral arguments do not persuade your company to act, perhaps economic and public pressure will.

Please, work with us to face this historic challenge now. We are available to meet within the next couple of weeks to discuss these issues in more detail. Please call me directly or have one of your staff contact our Global Finance Campaign Director, Ilyse Hogue, at the number below to confirm a date and time.

Sincerely,

Michael Brune  
Executive Director

## Chapter 5

# Crisis Management

Dealing with a crisis is an altogether too common challenge for firms and their management. This chapter considers the origins and nature of crises, with a focus on those that become public knowledge either because the company makes it public or because an outside party makes it public. The development of crises and the factors that resolve it are the focus. The chapter provides a framework, based on the nonmarket issue life cycle, that both reminds a reader about the origins and development of crises and provides an approach to managing in an environment in which crises can occur. The framework has five components: avoidance, preparedness, response, root cause analysis, and resolution. Avoidance is the most important, but when not all possible crises can be avoided, preparedness becomes paramount. Having a crisis management team and a crisis management plan can be crucial in dealing with a crisis in a responsible manner and in mitigating adverse consequences. If a crisis occurs, the plan should be implemented, but since the details of the crisis matter, there can be a myriad of things that are not covered by the plan. A response thus depends on the nature and details of the crisis. Effective communication can be crucial at this stage. Once a crisis has developed and an effective response has been implemented, attention should turn to root cause analysis. That analysis both helps identify problems that need to be corrected before the crisis can be resolved and lays a foundation for measures to avoid future crises.

The chapter cases are intended to develop sensitivity to possible crises of management's creation and to provide opportunities to make decisions as a crisis unfolds. The Buffalo Savings Bank case focuses on readjusting home mortgage interest rates upward during difficult economic times. Its objective is to assess how likely the readjustment is to create a crisis. The Mattel case provides an opportunity to make managerial decisions as a crisis involving lead paint on toys unfolds. The case is presented in segments, or episodes, that require a sequence of decisions. The Merck and Vioxx case is organized similarly and focuses on whether the company should take Vioxx off the market as new evidence is developed on its side effects.

## Cases

### **Mattel: Crisis Management or Management Crisis**

This case is designed to be taught in a sequence organized as events—information about product safety problems—unfold. To some extent this information is endogenous; i.e., it results from heightened investigations by Mattel management, but it is also to an important extent due to the normal pace of meeting delivery schedules. As written the case has three stages: the first dealing with the initial discovery of lead in the paint on toys, the second dealing with the discovery of lead in the paint on “Sarge” toy cars, and the third dealing with the revelation about lead in the plastic in some components of Mattel’s toy medical kit. The case also raises issues of social responsibility

with respect to possible harm to customers or their children. The case includes reputational concerns and private and public politics pressure on the company and the toy industry.

The “climate” during which these events occurred involved what seemed like weekly revelations of tainted and sometimes unsafe products from China. It was clear that a significant number of Chinese companies were cutting corners, or worse doctoring their products, to improve their profits. Melamine, for example, was apparently used because it is not easy to detect.

Mattel management could also have become overconfident about the ability of the company’s policies and procedures to avoid product problems. In part, inspections of suppliers’ factories may not be as effective as one might expect, as discussed in Chapter 24. Moreover, suppliers are often under pressure to meet tight deadlines and may cut corners to meet those deadlines. (As discussed in Chapter 24 Nike sought through better scheduling for deliveries to relieve pressure on its suppliers as a means of reducing the amount of mandatory overtime imposed by factory managers.)

Because of the findings of unsafe products the Chinese government came under considerable pressure to address the problems. Initially the government refused and blamed others, but at some point it decided that the problems had to be dealt with in a manner that would restore confidence in products made in China. The U.S. and EU governments were also under pressure to act to protect consumers.

## **Phase I**

Mattel discovered the problem in-house, which means that it was not yet under the scrutiny of the media. It, however, could not delay because if it were to issue a recall, it needed to do it soon before more product reached retailers’ shelves. In terms of Figure 5-1 Mattel’s objective should be to get to a resolution quickly with as little impact on the company as possible. Then its emphasis should be on avoidance of future problems.

The ostensible root cause of the crisis is a failure to follow procedures, but those procedures themselves may be part of the cause. Mattel maintained long-term relationships with its direct suppliers but relied on those suppliers to ensure that subcontractors and suppliers were providing goods that met standards. This delegation could be at the root of the problem. More fundamentally, suppliers have incentives to cut corners and shirk on meeting standards, and some suppliers will succumb to those incentives. Mattel could also lessen those incentives or make the penalties for violating standards more severe.

To get the issue behind it and resolve the impending crisis, the product has to be recalled. The recall should be sufficiently broad, so that it does not find itself in a position in which it has to make a series of recalls. The dilemma for Mattel is that it needs to act quickly on the identified products and may not yet know whether other products will need to be recalled. One thing that Mattel can do is identify the product lots on which the lead paint was used and at the least recall all those product lots. (As the case reveals Mattel issued several more recalls through September.) As Mattel identifies the root causes on the problem, it must deal with the causes.

The following decisions need to be made, and these can be used to guide the discussion.

1. Should Mattel recall the products? What are the risks if it does not do so? (It should be clear that Mattel has a moral obligation to recall the product or at least let the CPSC make the decision. If it does not, it risks not only harming children but also having the lead paint detected by some outside party. Regardless of whether it recalls the product, it will face products liability lawsuits. If it does not recall the product, however, it could be found to be negligent, as considered in Chapter 14.)
2. Should Mattel issue a voluntary recall or should it let the CPSC make the decision of whether to recall the product?
3. How broad should the recall be?
4. In whatever public announcement is made, should Mattel name the suppliers and explain what had gone wrong? (RC2 had not named the suppliers when it made its product recall.)
5. Should Mattel fire the supplier?
6. Should Mattel strengthen its quality control standards and procedures? If so, what particularly should it strengthen?
7. What should Mattel say to consumers and how should it say it? Should a rebate or refund be offered to people who had bought the product?
8. What should Mattel do with respect to retailers who have bought the products?
9. Should Mattel own more of the factories that supply its toys?

### **Crisis Phase II:**

The decisions here are the same as for Phase I with the addition of new information pertinent to whether to reveal the names of the suppliers. Also, this recall means that the root cause is something fundamental and not a one-time occurrence.

After discussing the decision and aftermath, the following questions could be asked:

1. Should Mattel have apologized in China?
2. Should Mattel investigate the “brutal conditions and illegal practices” allegations by China Labor Watch?
3. Should Mattel attempt to influence the decision in the EU regarding mandatory testing? (Note that Mattel prefers mandatory testing.) Or should it attempt to persuade the Toy Industries of Europe Association to change its position?
4. Should Mattel actively lobby in the United States to support mandatory testing? Should it oppose the Senate bill.
5. What should be done with the recalled products? Should they be sold in other countries that tolerate lower standards?

### **Phase III Management Crisis**

The article in *Consumer Reports* raises another dimension of the toy safety issue. Hard plastic is used in hundreds of products, and embedded in the plastic could be toxic or hazardous chemicals. Whether this is a significant health concern is not clear, and it is not even clear that it is a concern at all. What is clear is that safety and health activists are working to make it a concern and to require the elimination of the possible or imagined risks. (The issue here is similar to the precautionary principle used in the EU where a product or substance could be banned if it might pose a health risk. That is, the burden of proof is on the manufacturer to demonstrate that the

product or substance is safe.) This issue surfaced in North America when Canada considered banning plastic bottles made with bisphenol, a chemical used to make the plastic shatterproof. Activists in the United States called for a ban, and people who are nervous about their health turned away from the bottles. In October 2008 Canada banned the chemical bisphenol used in hardening plastic. According to the FDA the risk was negligible.

The potential hazard from lead in the plastic in the toy cuff is quite different from that of lead paint. Since young children put objects in the mouths and like to suck on those objects, there is a risk that lead from paint could find its way into the body. Sucking on hard plastic, however, does not pose the same risk.

With respect to the public politics associated with the hard plastic issue, there will be many companies that use the plastic that would oppose any regulation or ban. It seems unlikely that the Congress will act on this issue in the absence of a crisis. Nevertheless, Mattel should be attentive to those legislators who signed the letter. It should meet with them to discuss the issue and provide whatever information it can.

**Discussion questions:**

1. Should Mattel make a broader recall?
2. Is it risking products liability lawsuits? (See Chapter 14.)
3. What should it do in response to the letter from the member of Congress?
4. Formulate a comprehensive crisis management policy for Mattel for dealing with possible health and safety risks associated with its products? Should it seek more aggressive regulation by the CPSC?

**Developments:**

As a result of the problems encountered by Mattel and other toy manufacturers, in 2008 the United States enacted legislation requiring testing of toys by third-party laboratories. Mattel supported the legislation because it would protect children and protect the collective reputation of the industry against free-riders than skimp on safety precautions.

Mattel reported a 15 percent increase in its fourth quarter profit. CEO Eckert said in a conference call with analysts, “we have a lot of litigation around the world on things related to product recalls, and we’ve got a significant case coming to trial this year.”

Draft legislation was published in the EU in January to improve toy safety. The chair of the European Parliament’s consumer protection committee Arlene McCarthy commented, “This new law must take into account new toy risks and the fact that 90% of our toys are imported from China and other non-EU countries. It must stand the test of time and meet our demands that toy imports meet the highest standards.”

Sidney To, an executive with the toymaker Playmates Holdings Ltd. of Hong Kong, said his company had developed long-term relationships. He explained the company’s approach to its

suppliers, “It’s always better to work with the devil you know than the devil you don’t. You would like to work with them to solve any issues that come up rather than just cut and run.”<sup>62</sup>

The CPSC had opposed a larger budget and stronger enforcement powers—due to the Bush administration’s opposition to broader regulation. Legislation enacted in 2008 increased the budget for the CPSC.

In February 2008 the federal government indicted two Chinese companies and the U.S. importer that had intentionally falsified export licenses that allowed the wheat gluten tainted with melamine to be imported. The U.S. dog food manufacturers that included Menu Foods and Proctor & Gamble were not indicted because they were unaware that the wheat gluten had been contaminated.<sup>63</sup>

Safety problems with products made in China continued through 2008. In October several babies died in China and tens of thousands of others were sickened because melamine had been added to milk in China. That milk was also used in a variety of products, including candy and other foods. This forced the recall of many products by producers such as Cadbury and Unilever.

## **Johnson & Johnson and Its Quality Reputation**

Johnson & Johnson’s acclaim for its handling of the Tylenol poisoning had contributed to a stellar reputation among its potential critics, and its profit performance of consecutive quarterly increases had made it a favorite with investors. As Weldon explained, the company’s decentralization played a critical role in its reputation. That decentralization, however, may have contributed to its problems at the end of the first decade of the 21<sup>st</sup> century. J&J’s core principles were expressed in its Our Credo, which is reproduced in Chapter 23. The company appears to have forgotten about it, however. The McNeil consumer products unit experienced a series of quality control problems, and the company’s measures to address the problems exacerbated its problems. The quality problems received additional attention because they involved medications for children. The crisis threatened the company’s reputation and performance.

The continuing series of problems at multiple plants and with multiple products suggests that there is a fundamental lack of emphasis on quality control in at least some parts of McNeil. This is the root cause of J&J’s crisis. The company’s approach seems to have been conditioned on whether the problem involved a safety or health risk, an “adverse event” in its terminology, or a quality problem. (See the Goggins comment.) The former would be reported to the FDA, whereas the latter were dealt with internally by trying to retrieve the deficient product. This approach seems to be the root cause of the failure of the company’s responses. J&J was in a position in which it could only try to limit the harm and prevent further problems.

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<sup>62</sup> *Wall Street Journal*, August 17, 2007.

<sup>63</sup> *New York Times*, February 7, 2008.

The response by CEO Weldon in which he took responsibility was at best too late and at worst an incredible claim that its “response to the issue was the most responsible it could possibly be.” Why did he wait two months before making a statement? One possible answer is that he believes strongly in J&J’s decentralization and hence allowed McNeil management to deal with the problems.

J&J’s problems in the United States may have encouraged social activists and NGOs to engage in private politics, as occurred in China.

Will the congressional attention result in actual harm to J&J? The answer is likely “yes.” Congress is highly unlikely to enact legislation because of the J&J episodes, but members of Congress are likely to pressure the FDA to act. Even in the absence of congressional pressure the FDA is likely to act despite there being no safety problem. The FDA’s action is likely to focus on McNeil’s manufacturing operations, as suggested by the comment about Puerto Rican plant. In addition, the FDA can pressure the company to recall products because of quality problems, particularly products that do not correspond to the label indications. For recurring problems the FDA can impose fines, and private lawsuits can be filed against the company even if there are no injuries.

**Discussion questions:**

1. Did J&J address the quality problems in a manner consistent with *Our Credo*? Why or why not?
2. What is the root cause of J&J’s problems?
3. Were its initial responses sufficient to address the root cause?
4. Did the company adequately communicate with its multiple audiences (e.g., consumers, the FDA, Congress, ...)? What could it have done better?
5. Should it have followed a policy of retrieving product with quality problems rather than recalling the product?
6. Why did it take two months before CEO Weldon began to communicate to the public and government?
7. Should a recall be the standard response to a quality problem or should retrievals be used in some instances? If the latter, which instances?
8. Is J&J’s remediation plan likely to be effective?

**Update:** The company’s quality problems continued. In November 2010 the FDA released a report on problems at the Puerto Rico plant. The report concluded that it had little reason to believe “that the current laboratory controls are adequate to assure that drug products conform to appropriate standards of identity, strength, quality and purity.”<sup>64</sup> Karen Riley, spokesperson for the FDA commented, “Clearly, this inspection shows that the company continues to have serious quality control issues at the plant and that it is not in compliance with current good manufacturing practices required by federal law.”<sup>65</sup>

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<sup>64</sup> *New York Times*, November 27, 2010.

<sup>65</sup> *New York Times*, November 27, 2010.



The company continued its series of recalls pertaining to quality control problems. The recalls were not associated with safety issues but with quality and labeling issues. For example, in November 2010 McNeil recalled 9.3 million bottles of Tylenol Cold Multi-Symptom products because of inadequate labeling. The labels failed to show that the products contain small amounts of alcohol—less than 1 percent—that are used to flavor the product.<sup>66</sup>

In January 2011 a jury in a federal court in Texas concluded that J&J should pay \$482 million to a doctor whose patent was infringed.

In May 2011 Johnson & Johnson recalled 11,700 bottles of its HIV AIDS drug Prezista in Europe and Canada. Four customers had complained of a musty or moldy odor, and J&J found trace amounts of TBA in the medications. TBA is “a byproduct of a chemical preservative sometimes applied to wood used to transport and store products.”<sup>67</sup> J&J had also associated TBA with its recalls of Tylenol, and Pfizer had cited TBA in its recall of Lipitor in 2010.

Shareholders had sued Johnson & Johnson management because of its manufacturing problems and alleged kickbacks to doctors and pharmacists to increase sales. The plaintiffs “allege that Johnson & Johnson’s decentralized management was a ‘recipe for disaster’ that gave top executives and board members ‘plausible deniability’ to claim they were unaware of a range of severe problems that dragged on, some since the late 1990s.”<sup>68</sup> The parties reached a tentative settlement in which a committee of independent board members would receive reports directly from top executives so that rapid action could be taken.

#### **Update: Financial Performance**

Earnings per share decreased from \$4.78 per share in 2010 to \$3.49 per share in 2011. The company explained the decrease in profits: “The decrease was primarily due to costs associated with product liability and litigation expenses, the impact of the OTC and DePuy ASR™Hip recalls and the restructuring expense related to the Cardiovascular Care business.” (Johnson & Johnson, 2011 Annual Report) For the first quarter 2012 sales were down slightly from the previous year and profits were up slightly.

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<sup>66</sup> *Wall Street Journal*, November 26, 2010

<sup>67</sup> *Wall Street Journal*, May 12, 2011.

<sup>68</sup> *San Francisco Chronicle*, July 13, 2012.

## Part I Integrative Case

### Wal-Mart: Nonmarket Pressure and Reputation Risk (A)

The two principal questions in this case are (1) what Wal-Mart should do regarding the social pressure it faces and (2) whether it should adopt a different approach to its nonmarket environment. The first question pertains to the short-run, and the second question is longer-run, although a change could be implemented quickly.

A prior question that could be asked is how Wal-Mart came to be in the position it is in. Wal-Mart experienced spectacular growth through the 1990s, following a strategy of providing value through low prices. It was able to provide low prices and obtain high profits because of its efficiency and its buying power. Wal-Mart had focused its growth in small towns and suburbs. Wal-Mart also provided opportunity for advancement within the company, and opportunities were plentiful as it continued to open more stores. The company hired young and old, many of whom were saving for college or supplementing their household or retirement income. Wal-Mart became the second largest employer after the federal government and provided value to many millions of consumers.

Those benefits came at some cost, however. Wal-Mart caused many small stores to go out of business, and along with shopping malls harmed the traditional downtown areas in some towns. Some critics claimed that it was affecting the culture in small towns. Wal-Mart was also criticized for low wages, for not providing benefits to its employees, and for its aggressive opposition to the unionization of its employees. Many of the criticisms were strategic in the sense that they reflected the self-interested advocacy intended to harm Wal-Mart before the public. For example, Wal-Mart paid low wages, but those wages were not lower, and may have been higher, than those paid by other mass retailers. Moreover, its benefits packages were probably comparable or better. Wages and benefits were probably higher than those paid by small retailers, including those that went out of business because of Wal-Mart. Many of its young employees received benefits through their families, and many of its older employees received benefits under Medicare. Some of its employees were receiving Medicaid, which was also the case with a number of other employers in low wage industries.

This raises another question: Why was Wal-Mart the target and not Home Depot or Target or another big box retailer. One answer is simply that Wal-Mart is the biggest and hence the natural target. Another is that it has had the greatest impact along the lines raised by its critics. A third, as indicated in the case, is that it threatened union jobs in the supermarket industry. Home Depot and Target did not provide a threat to unions. It also unleashed NIMBY movements as it modified its store opening strategy and began to target large cities. Other big box stores also generated NIMBY opposition.

Most of the social pressure on Wal-Mart comes from private politics. In the case of the national campaigns against the company, the private politics is well-organized and well-financed. The motivation for the private politics campaigns is primarily the threat to unionized supermarket employees resulting from Wal-Mart's importance in the grocery market. The unions have also had no success in recruiting Wal-Mart employees. The SEIU and UFCW set up and staffed Wal-Mart

Watch and WakeUpWalMart.com. This is also an opportune time, since Kerry had lost the election leaving a number of Democrat operatives with nothing to do. The SEIU also financed the Center for Community and Corporate Ethics that focused on Wal-Mart. The unions also financed the media campaign against the company. With this leadership others that had complaints about Wal-Mart saw this as an opportunity to advance their agenda. The teachers' unions jumped on Wal-Mart to oppose the support of school voucher programs. Other interest groups including MoveOn.org and ACORN also joined the fray.

The opening of stores in large cities faces opposition of two types. The first is from unions that often are stronger in large cities than in the small towns and suburbs where Wal-Mart had concentrated its store openings in the past. The second is from NIMBY movements. This was not particularly a strong force in Chicago, but it was in Inglewood, California and in New York City. The Chapter 8 case *Wal-Mart and Its Urban Expansion Strategy* addresses the issues surrounding Wal-Mart's attempt to open two stores in Chicago.

The private politics campaign poses two kinds of problems for Wal-Mart. First, it may cause some of its current customers to stop shopping at its stores. How big this effect would be is not clear, since many of its customers will still want value. Second, it may harm Wal-Mart's market strategy of seeking customers with bigger wallets who would buy higher margin items such as consumer electronics. These consumers have more discretionary income and could easily not go to Wal-Mart for an HD television, for example, even though they would have to pay more elsewhere.

The public politics threats are also important. The Wal-Mart bills are of concern in states in which unions are strong and Democrats are in control of the legislature and governor's office. The Republican governor in California vetoed the bill. The other institution to control these bills is the courts. The courts overturned the bill in Maryland, as I recall, on the grounds that it did not provide equal protection to the companies subject to the provisions of the bill.

Wal-Mart's nonmarket strategy had two components. One was to counter the information, or misinformation in its view, provided by its opponents. The second was to develop a nonmarket strategy to address a set of fundamental issues, such as the environment and sustainability, that might establish a stronger reputation for social responsibility. This could appeal to current customers and particularly to potential customers with bigger wallets and greater discretion regarding their purchases. Some steps to address social issues such as the environment and the topical issue of health care benefits could appeal to the new customers it sought to attract.

Some responses were out of the question. Wal-Mart had no reason to raise the wages it paid or provide more generous benefits, nor change its working conditions, although it should make sure that it is not violating the employment laws. The large number of applicants for jobs at Wal-Mart speaks volumes to the critics. Moreover, Wal-Mart employees are generally happy with their jobs. Wal-Mart certainly did not want to make it any easier for unions to sign-up its employees. The public does not particularly like unions, and many union members shop at Wal-Mart despite its opposition to unionization. Wal-Mart also does not want to assume the kinds of responsibilities that General Motors assumed after WWII. As CEO Scott said, retailing cannot play such a role. His reasoning was probably that retailing is very competitive and margins are thin, which makes it difficult to pay wages and provide benefits higher than required by the labor market.

Another important characteristic of its operations was revealed in the leaked memo. After a year on the job store employees do not become more productive. This means that Wal-Mart can operate by attracting short-term employees rather than those who envision a career with the company accompanied by rising real income. (The exception is those employees who enter management.) This also means that Wal-Mart can position itself in the labor market as providing a second income to a household. This may be a lower-cost alternative than some of the measures, such as higher wages and more generous benefits, its critics call for.

Little information about Wal-Mart's market strategy is provided in the case, although many students will be familiar with its strategy. The two aspects that might be the focus of a discussion are its urban expansion strategy and its goal of attracting shoppers with larger wallets. The latter group could be influenced to some extent by Wal-Mart's reputation and public image. The opposition to opening stores in urban areas can be lessened by taking some steps, but another way to lessen opposition is to essentially buy off the opposition. Wal-Mart attempted to do this, for example, by providing local businesses with opportunities to locate near its stores and to provide free advertising on Wal-Mart's in-store communication system. More would likely be required to eliminate the opposition by local merchants.

An integrated strategy involves a nonmarket strategy to reduce the pressure and improve its reputation, and the potential reward is both from its current customers and from enabling a market strategy designed to attract customers with bigger wallets.

The following questions can be used to lead the discussion.

**Discussion questions:**

1. Why has Wal-Mart become the target of this nonmarket pressure and why did it happen when it did?
2. What should Wal-Mart do about the private politics campaigns? Should it fight back, bargain with the groups supporting the campaigns, or concede to their demands?
3. What should Wal-Mart do about the public politics campaigns?
4. Should Wal-Mart drop its opposition to unionization?
5. Formulate an integrated strategy for Wal-Mart.

**Developments:**

The details of Wal-Mart's new strategy are presented in the Chapter 20 case *Wal-Mart: Nonmarket Pressure and Reputation Risk (B): A New Beginning*. As that case indicates Wal-Mart adopted a very aggressive social responsibility policy, particularly with respect to the environment. This policy had some effect, although it is difficult to assess its full impact. It led the organizers of one of the campaigns to call off their campaign. To illustrate the effect, in September 2007 I chatted with a first-year MBA student at Stanford University who was interested in the environment and corporate social responsibility. She said that she and other students with similar interests had been discussing whether they could make a greater impact working for an NGO or working for Wal-Mart.

With the economic slowdown in the summer of 2008 many retailers experience a decrease in sales. Wal-Mart's sales, however, increased, as cautious customers turned to Wal-Mart value. In October 2008 after the Dow Jones Index was just above 8,000 the only company in the Index whose value had increased during the past year was Wal-Mart.