

What Every CEO Needs to Know About *Nonmarket* Strategy

In a global economy, sustained competitive advantage arises from tackling social, political and environmental issues as part of a corporate strategy — not just pursuing business as usual.

BY DAVID BACH AND DAVID BRUCE ALLEN



THE LEADING QUESTION

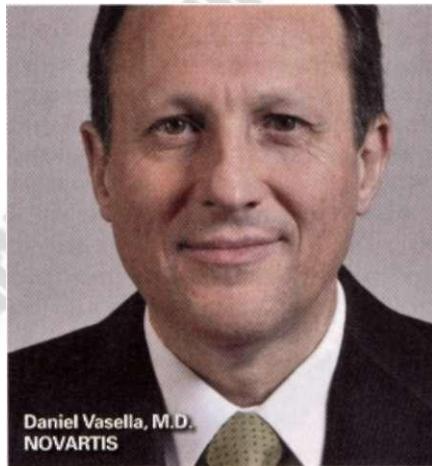
Why should companies pursue a nonmarket strategy?

FINDINGS

- ▶ Companies face risk in nonmarkets, from government regulations, social campaigns and political movements.
- ▶ A nonmarket strategy allows a company to shape the environment in which it operates, creating opportunities.
- ▶ Managing key issues and actors is crucial to success in the nonmarket.

NOVARTIS AG, the world's fourth largest pharmaceutical company, has been engaged since 2002 in a high-profile public battle with the Indian government over Glivec, a popular cancer drug. (The drug is known as Gleevec in the United States.) India has denied Novartis a patent for Glivec, alleging it does not offer "improved efficacy" over its predecessor.¹ Novartis, which has obtained patents for Glivec in more than 40 countries, including China, insists that India's stringent requirements for novelty violate international intellectual property treaties. The company is waging its campaign in courtrooms and ministries, and with the public — its Web site features videos of Indian patients extolling the drug's benefits and Indian experts detailing the dire consequences for patients deprived of Glivec.

Novartis, however, was not content simply to fight for its intellectual property rights. In a subtle and related thrust, the company offers Glivec to needy Indian patients at dramatically reduced prices. The program is featured among the company's "corporate citizenship" initiatives, which also provide leprosy and tuberculosis drugs to millions of patients free of



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charge and malaria drugs to tens of millions more at cost. Novartis proudly trumpets that its billion-dollar "access-to-medicines" program has reached more than 80 million patients worldwide, many of them in India.³ In balancing assertive property rights and pharmaceutical philanthropy, Novartis is shaping the environment in which it competes. In short, it is pursuing a *nonmarket strategy** (See "Creating Nonmarket Strategies: The (IA)³-Framework.")

Nonmarket strategy recognizes that businesses are social and political beings, not just economic agents. Because companies create and distribute value, a plethora of actors seek to influence them — formally, through laws and regulation, and informally, through social pressure, activism and efforts to shape the public perception of business. Companies can't escape this. Smart executives, therefore, engage with their social and political environment, helping shape the rules of the game and reducing the risk of being hemmed in by external

actors. Yet, few companies are prepared to do the hard work and commit long term to developing an effective nonmarket strategy. Fewer still understand how to integrate market and nonmarket strategies to sustain competitive advantage.

Novartis has figured that out. Fighting for property rights and giving away life-saving drugs happens in arenas where the exchange is political and social, not economic. However, both actions are fundamentally strategic: Novartis defends strong patent protection essential to its business model, and undermines its critics by demonstrating its commitment to India's well-being. Its nonmarket strategy is carefully aligned to support its market strategy of competing via patent-protected, blockbuster drugs.

Defending intellectual property rights and demonstrating good corporate citizenship are just two of the many nonmarket issues facing CEOs. Increasingly, CEOs cite as their greatest challenge the complexity of ever-growing and seemingly irreconcilable

CREATING NONMARKET STRATEGIES: THE (IA)³-FRAMEWORK

To design competitive nonmarket strategies, executives first need to map their company's specific nonmarket environment. Working with CEOs and executives from a broad range of industries and building on David Baron's earlier work, we have designed the (ia)³-framework, a simple tool that provides a nonmarket snapshot much the same way Porter's Five Forces captures essential market characteristics. We have deliberately proposed a broad and encompassing view of the company's nonmarket environment. That creates the challenge of separating vital aspects with a real potential to affect the company's bottom line from the cacophony of politics. A corporation cannot and should not have a position on everything — that would be the opposite of strategy.

Most managerial frameworks for corporate social responsibility are organized around the analysis of stakeholders. Because large multinationals in particular have an almost unlimited number of

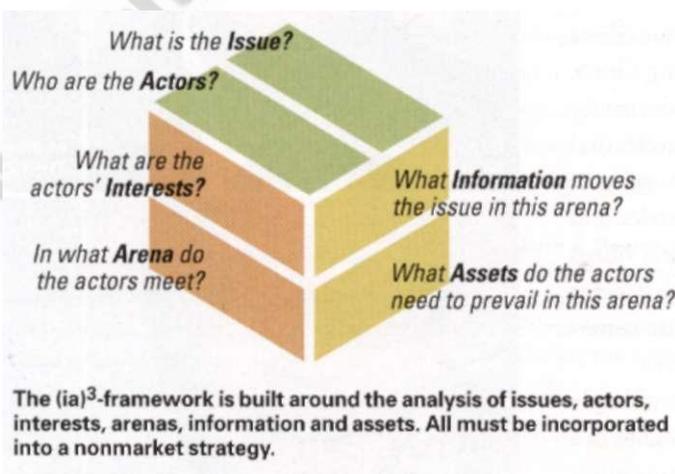
potential stakeholders, more recent approaches have put forth the idea of *pivotal* stakeholders. Nonmarket strategy takes a different approach. The primary focus is on issues. To promote strategic

of social and political issues that really matter to a given company. Just as a Five Forces analysis has to be conducted separately for each industry in which a company operates, an (ia)³ analysis should

together they map the company's nonmarket environment.

How do you decide which issues matter? The best starting point is the company's existing market strategy. Depending on how the company competes in the market, its plan for creating value, certain nonmarket issue's will matter and others will not. The first challenge for executives is to identify those issues — and only those issues — that are salient for the company's ability to create and appropriate value. And that is why nonmarket strategy needs to be led by managers, as they know their products and markets best.

The (ia)³-framework is built around the analysis of *issues, actors, interests, arenas, information and assets*. To manage the nonmarket environment proactively, we recommend executives ask themselves six questions, with each question leading directly to the next:



nonmarket thinking and to get to actionable nonmarket strategies, we suggest dissecting the thicket of politics by identifying the handful

be performed for each critical issue. Each (ia)³ offers a launching point for a specific nonmarket strategy to tackle the issue, and

What is the issue? A company's nonmarket environment is organized around issues. A business should take a position on an

stakeholder demands. Our own research, through the IE Business School Center for Nonmarket Strategy in Madrid of more than 100 senior executives from sectors as diverse as software, media, telecommunications, pharmaceuticals, infrastructure and steel, confirms the same basic finding: More and more top executives feel they spend too much time away from the core business, juggling a multitude of "nonbusiness" issues that are difficult to resolve and seen as not creating value.⁴

CEOs need to make the jump from thinking about isolated nonbusiness issues and recognize that, together, they form the nonmarket environment of the company. Nonmarket strategy starts with a simple, dual premise — first, that issues and actors "beyond the market" increasingly affect the bottom line, and, second, that they can be managed just as strategically as conventional "core business" activities within markets. The challenge for CEOs and their leadership teams is one of simultaneous

separation and integration. To manage successfully beyond the market, executives must recognize the important differences between the company's market and nonmarket environments but then take an integrated, coherent and strategic approach to both arenas. That is the key to turning perceived non-business issues into strategic opportunities and thereby building sustainable competitive advantage, as examples from leading corporations show.

Toyota Motor Corp. is the market leader in hybrid cars. But the company has stretched the competitive playing field beyond the market. In California, it successfully lobbied to include its flagship Prius hybrid model in a program granting low-emissions vehicles access to the state's carpool lanes, even with only a single occupant. Support from environmental groups made it easy for legislators to endorse the proposal, one that cost the state of California next to nothing and that burnished its environmental credentials. With minimum financial investment,

issue if the issue's resolution could significantly affect the company's ability to create and/or appropriate value. That applies both to the upside and the downside — it is not just a matter of neutralizing threats but also recognizing issues whose favorable resolution would generate a new opportunity.

Who are the *actors*? Identifying the issue highlights the importance of "interested parties" and the potential conflict among them. So the next important task is identifying the actors who care about the issue, which are generally those with an economic or ideological stake in the issue. In politics, what matters most is organization. Organized groups — such as farmers demanding agricultural subsidies—are often more powerful than unorganized consumers who have to foot the bill via higher food prices or taxes, even though the latter outnumber the former.

What are their *interests*? Building on the identification of actors who care about an issue, the next critical question is what these actors actually want. What

motivates them? What do they hope to achieve and how critical is this issue for them? Also, how homogenous is a particular actor? Do all members feel the same way about the issue or is there an internal split that provides an opening for engagement? Probing every identified actor in this respect permits the drawing up of a strategic map that is critical for the identification of potential allies and key adversaries.

In which *arena* do these actors meet? Nonmarket issues can play out in multiple settings, from courtrooms and regulatory proceedings to parliamentary committee hearings and industry forums all the way to the news media, the public domain or the blogosphere. Knowing where actors meet matters greatly because the rules of the game vary greatly across setting. Shell lost the battle over the future of the abandoned Brent Spar oil rig because it failed to appreciate that Greenpeace had shifted the arena — away from the realm of British environmental regulation where the company's scientific arguments had proved

compelling and into the public domain where Greenpeace's emotional appeal was far more effective.

What *information* will move the issue in this arena? If money is the currency of markets, information is the currency of the nonmarket environment. But the kind of information that can influence the resolution of an issue varies across arenas. Public opinion data will be more effective in lobbying critical members of a congressional committee, for example, than in a courtroom or a regulatory hearing. Owners of critical information often have a decisive advantage. Since politics — whether in formal or informal settings — is all about persuasion, having the right kind of information for the issue and arena in question is key to success.

What *assets* do the actors need to prevail in this arena? Finally, while having the right kind of information for a given issue and arena is critical, other assets matter as well. A company's reputation and its perceived trustworthiness

are essential if it wants to influence an issue in the public domain. Conversely, detailed knowledge of committee procedures or key members' concerns and views are necessary to influence an issue in the context of a parliamentary committee. A broad network of contacts and the ability to assemble and mobilize coalitions quickly can be critical assets. On the other hand, association with the wrong actors — a disgraced former dictator, for example, or a controversial policy group — can be a liability.

Just as a rigorous industry analysis does not guarantee market success, performing an (ia)⁵ analysis alone does not deliver a nonmarket edge. But it sets the stage for proactive as opposed to reactive nonmarket management. By drawing up a strategic map — identifying who cares about an issue, what the various actors want and in what arena they meet — a company can plot what information and assets it may need to shape the issue's evolution in a way that favors its business interests.

Toyota managed to give its product a decisive competitive advantage.⁷ Building on this success, the company next won Prius owners the right to park for free at public meters in Los Angeles and other cities. Through skillful nonmarket management that deftly complements the company's existing market strategy of selling the product primarily to upper-middle-class, environmentally conscious urban professionals, Toyota has reinforced its competitive advantage.

Or consider how Vodafone Group Pic turned a serious political challenge into a source of market differentiation. When the European Commission began a quest to lower cross-border roaming charges within the European Union, a lucrative income stream for all European mobile (cell) phone operators was suddenly threatened. The situation was particularly dire for Vodafone, which was more dependent on roaming revenues than its competitors. Operating in 24 of the European Union's 27 markets, it was the only major operator without a fixed-line business. But whereas most European operators did little other than voice strong opposition to any plans to cap roaming charges, Vodafone embarked on a skillful two-pronged strategy: First, it created Vodafone Passport as an opt-in program for frequent border crossers that applies home rates to a call made from another country in exchange for a flat 99c per call fee. It then used the program's popularity as the basis for a targeted lobbying campaign, arguing that binding regulation was unnecessary to bring down prices.⁸ The campaign ultimately proved futile as the European Parliament enacted binding rules two years later. But its preemptive response to this emerging nonmarket challenge gave Vodafone an edge over competitors, enabling it to tout what would become a mandate with an innovative product and differentiator, adjusting early to new realities and shaping to some extent the content of the new rules.

A Global Imperative

Novartis, Toyota and Vodafone are among the growing list of companies that deliberately manage beyond the market, corporations that employ carefully designed nonmarket strategies to create business opportunities in their social and political environment. Their investment in nonmarket

strategy is being driven by four factors, all of which are tied to globalization:

Multiple audiences: Many companies now source from or sell to countries around the world and must therefore navigate simultaneously many distinct nonmarket environments that are often characterized by conflicting social and political values. A prime example is Yahoo! Inc.'s passing on of e-mail files from a Chinese dissident to Chinese authorities in 2004. While the company claimed it was merely complying with local law, back home in the United States it got sued, blasted by activists and even publicly reprimanded by Congress.

The globalization of nongovernmental organizations: Not only has business become global, but also NGOs and activists. And these nonmarket actors often use modern communication technologies, the Internet and the 24-hour news media even more effectively than multinationals. In an epic struggle, Greenpeace International's own on-the-site instant multimedia coverage of events spoiled Royal Dutch Shell pic's plans to sink the Brent Spar oil storage buoy. Greenpeace understood the power of images, emotions and the modern media, Shell did not.

New regulatory hurdles: Paradoxically, while globalization has meant more market opportunities, it has also meant new nonmarket challenges. Countries around the world have opened up industries, including financial services, telecommunications, energy and transportation, creating tremendous market opportunities. But in parallel, governments have created new regulatory agencies for these sectors with which investing corporations have to grapple. What's more, newly adopted regulations are often far from uniform across markets. Consider the case of antitrust policy, which has been strengthened around the world over the past decade. European and U.S. rules differ considerably, as General Electric Co. and Honeywell International Inc. painfully learned when the European Commission rejected their proposed merger in 2001 despite easy approval in the United States.

Competitive edge: Finally, globalization has made market competition even tougher. Who hasn't outsourced noncritical business functions, focused on their core competency and shed underperforming assets? Building lasting competitive advantage in the market has become harder, and leading companies



BP sought to align itself with sustainable energy resources, rather than the old-line commodity energy business.

increasingly look beyond the market to gain an edge. That is what BP did with its "beyond petroleum" initiative. Stuck in a commodity business with little control over prices and few opportunities for differentiation, BP took a big political gamble by becoming the first major oil company to acknowledge global warming publicly and announce plans to become a more sustainable energy company. Diversification into renewable energy sources, internal carbon trading to reduce emissions and aggressive advertising highlighting the company's actions measurably boosted reputation, staff morale and access to key government decision makers, all of which contributed to competitive advantage. As Dick Olver, then BP managing director of exploration and production, affirmed: "This was a business decision, a cold hard way of getting competitive advantage by taking a distinctive position."⁷ What was innovative, though, was that the market repositioning was driven by taking a *political* position on a highly controversial issue. BP stretched the competitive playing field beyond the market and achieved differentiation through a daring non-market positioning.

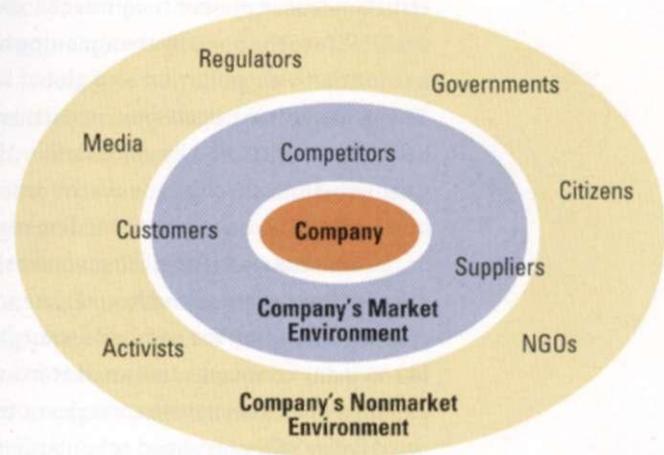
In light of the nonmarket environment's growing importance for the bottom line, it is essential for executives to get a firm grasp on the critical differences between managing within markets and beyond them.

Markets and Nonmarkets

We all know what a market is. Traditionally, a market is the place where a seller and a buyer come together — and haggle over price. In a modern economy, the market includes a good deal more. A company will meet with suppliers and buyers separately and together, in real and virtual space, across time and across continents. To keep it exciting, competitors meet with the same suppliers and buyers, vying to make a better deal. The company's relationships with these actors comprise its market environment. Here we find the conventional "value chain"; and most managerial attention is focused on building competitive advantage, winning customers and making a profit. Markets are powerful precisely because they have straightforward cause-and-effect relationships and several universal "rules": All else being equal, an increase in price

THE NONMARKET ENVIRONMENT OF BUSINESS

While nonmarket factors are often viewed as external to the core business, they shape the environment in which a company operates.



leads to a drop in demand; more competition means lower prices for consumers and lower margins for producers; paying more for key supplies means either lower margins or less revenue and often both. These rules hold equally in markets for soap, supertankers and software because money is the universal exchange medium across all markets.

But markets do not exist in a vacuum; they are surrounded by social, political and cultural spheres. (See "The Nonmarket Environment of Business.") What happens within this *nonmarket environment* inevitably shapes dynamics within markets. What exactly is this nonmarket environment of business? The simple answer is, all relationships that do not unfold within markets yet nevertheless affect the company's ability to reach its business objectives. But why throw everything together? Surely there are important differences between lobbying a key member of Congress, seeking regulatory approval for a merger and teaming up with an NGO to fight hunger. Without a doubt. But in our work with senior executives across a broad range of industries, we have found that compartmentalizing nonmarket management into, say, government affairs, public relations and corporate social responsibility has two drawbacks. First, it misses the important synergies between the different pieces. Consider again the examples of Novartis, Toyota and BP, all of which feature simultaneous lobbying and corporate social responsibility — they are mutually

reinforcing. By showing its commitment to the poor in India, Novartis has won important allies in its fight for patent protection while undermining criticism from opponents concerned about drug availability to the poor. By championing hybrids as a solution to air pollution and global warming, Toyota has become a government partner that can help shape policy. And by voluntarily reducing its CO2 emissions through innovative internal carbon trading, BP can influence binding regulation.

Second, compartmentalizing nonmarket management makes it harder truly to integrate nonmarket considerations into the corporate strategy process. In too many companies, nonmarket management amounts to an afterthought, a series of uncoordinated policy offshoots aimed at nonbusiness actors. Yet, gaining a competitive advantage requires a much more comprehensive approach: carefully designing nonmarket strategies that complement, reinforce or enable market strategies.

Nonmarket Management

So let us focus on what all nonmarket management has in common. The best way to do that is by highlighting how the nonmarket environment differs from markets. (See "Some Differences That Matter.") As we argued earlier, markets are simple, but powerful mechanisms with near-uniform, generally predictable cause-and-effect relationships. Nonmarkets are far less uniform and predictable. Regulatory processes vary widely across countries, sectors and issue areas. The way the media responds to a story in one culture often differs widely from the response in another culture — the firestorm ignited in the Arab media by the publication of cartoons depicting the Prophet Mohammed in a Danish newspaper is a powerful example. Prior experiences, rather than cross-cultural generalizations, are often the best guide.

The nonmarket environment also lacks the fungibility of money as an exchange medium. You can invest money gained with product A one-to-one into the development of product B; but recognition for having worked with a human rights group in Nigeria will not help you get approval for a merger in Brussels. What is at the heart of nonmarket exchanges is not money but information. And information is highly context specific. Public misconceptions notwithstanding, the currency of

SOME DIFFERENCES THAT MATTER

The currency of nonmarkets differs markedly from traditional markets, which makes it imperative for companies to become familiar with it.

MARKET	NONMARKET
Money	Information
Leadership	Coalitions
Flexibility	Consistency
Predictability	Uncertainty
Value	Values

lobbying is information, not money — superior information about policy alternatives and their costs and benefits, preferences of key players and the functioning of a particular policy process are the keys to success. While money often helps, it can sometimes become a liability outside the market — the pharmaceutical industry became the target of HIV/AIDS activists precisely because new intellectual property treaties had dramatically boosted pharma profits.

In markets, leadership is everything. Former CEO Jack Welch famously set a goal for GE either to be first or second in a market or to get out. In innovative, growth-oriented companies, the goal is to "beat the competition to market," to secure "first-mover advantage" and to be the "industry leader." In the nonmarket environment, in contrast, it is hard to do anything alone and companies need to know how to work with others to excel. That does not mean that the nonmarket sphere lacks competition. In fact, any lobbyist trying to get a few minutes with a top decision maker, any corporate counsel embroiled in a major lawsuit and any brand manager vying for the seal of approval from a well-known nongovernmental body knows how fiercely competitive the nonmarket environment is. But in politics, having allies is key. Governments are wary of catering to individual companies; but looking after important industries is a principal concern. A recent McKinsey study found that only 13% of large corporations engage nonmarket actors to manage sociopolitical issues even though 30% believe doing so would be very effective. In contrast, 27% resort to advertising to manage such issues even though only 20% believe that is effective. Working with

nongovernmental groups, public bodies and even formal competitors on nonmarket issues is not easy, but the benefits are often considerable.⁸

Even though citizens increasingly demand that companies contribute more to social and environmental ends, when they do, the public is often skeptical of underlying intentions. Since intentions cannot be seen, only behavior, there is a premium on consistency in the nonmarket environment. Companies and managers have rightly emphasized the importance of flexibility and rapid responses to market trends. Spanish apparel multinational Industria de Diseno Textil S.A., also known as Inditex, has built its entire competitive advantage around flexibility and market responsiveness. Through its Zara, Bershka and Massimo Dutti stores, it puts out at the start of a season hundreds of designs in small volumes, collects sales data in real time and mass-produces only those that sell best.

The nonmarket environment works differently. A company cannot take multiple positions on key social or political issues, monitor responses and drop those that fail to gain traction ("Hunger doesn't sell, but climate change does, so let's cancel the hunger project!"); it would be accused (rightly) of cynicism. When New Coke failed in the market, Coca-Cola withdrew it. There was damage for sure, but it was short term. When a refinery explosion in Texas and several pipeline leaks in Alaska showed that BP was still very much a petroleum company despite its recent diversification, it could not simply junk its new "beyond petroleum" strategy and announce the company was "back to petroleum." To overcome public skepticism and reap nonmarket benefits, consistency and a long-term commitment are key.

Finally, whereas market competition is fundamentally about creating value — for customers, owners, but also society — management beyond the market is ultimately about *values*. Nonmarket strategy, like market strategy, must be steeped in the company's values, particularly if the goal is long-term performance. Opportunistic lobbying for a particular policy may be advantageous in the short term, but is unlikely to deliver the long-term benefits that mutually reinforcing commercial, social and political actions can yield. It is unlikely, for example, that Toyota would have succeeded with

its pitch for carpool access for hybrid vehicles if the rest of its fleet consisted exclusively of gas-guzzling SUVs. It did succeed, because the approach was aligned with the company's values as reflected in its overall strategy and conduct.

A good example of fully integrated market and nonmarket strategy, with the latter straddling both social and political domains, is Accor Services. A subsidiary of the French company Accor SA, Europe's leading hotel and hospitality holding, Accor Services' stated objective is to offer "solutions to reconcile the imperatives of the right balance between professional and private life." The company is best known for its meal vouchers that employers can provide their employees pretax as an additional benefit. In many markets, it also provides pretax vouchers to cover kindergarten fees. In the domain of corporate social responsibility, Accor Services has been working for many years with a variety of NGOs to fight hunger and to improve childcare in developing countries. In Spain, it has recently teamed up with the country's Health Ministry to launch a "healthy food" certification program among 26,000 stores and restaurants in which its vouchers can be redeemed.¹⁰ As a partner of the government in the promotion of a key public policy objective—promoting healthful eating within the work force — the company has used its access and standing to lobby for extending the pretax kindergarten voucher program, currently from birth to age

Novartis' nonmarket strategy includes delivering antimalaria treatments at no cost to developing countries.



three, to cover up to age six as well. Clearly, this extension would provide the company a tremendous business opportunity. While the efforts are continuing, Accor executives are certain they are being heard because of the company's prior initiatives and the broad consistency of its commercial, social and political activities.

These and other examples show the considerable upside of purposively managing beyond the market. Most corporations have viewed their social and political environment as a given. But with the growing nonmarket stakes, that is no longer an option. Most executives take for granted that it is in their interest to shape the markets in which their companies compete. Prior to Michael Porter's seminal work, strategy was mostly about positioning the company in a market environment that was largely taken as fixed. Porter's Five Forces systematized managers' analysis of the competitive relationships within their markets and in effect provided them with the tools to shape the terms of competition actively. The next frontier in strategic management is deliberately to shape the nonmarket environment, creating new market opportunities and lasting competitive advantage through a carefully crafted nonmarket strategy. But that requires an important mind-set change in the C-suite: Corporations are social and political actors, whether managers like it or not. Reducing the company to its role as an economic agent, and managing accordingly, leaves the nonmarket environment to others. Politicians, regulators, nongovernmental organizations and activists won't hesitate to impose new rules of the game on an industry, unless companies themselves become active participants in the process. As a popular saying in Washington goes, "In politics, if you are not at the table, you are on the menu!" This is why leading corporations are beginning to stretch the competitive playing field beyond the market, and in the process they are turning social and political issues from mere nuisance to strategic opportunity.

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3. See D. Baron, "Integrated Strategy: Market and Non-market Components," *California Management Review* 37, no. 2 (winter 1995): 47-65; D. Baron, "The Nonmarket Strategy System," *Sloan Management Review* 37, no. 1 (fall 1995): 73-85; and D. Baron, "Business and Its Environment," 5th ed. (Upper Saddle River, New Jersey: Pearson, 2006). Our goal in this article is to provide senior executives with a managerial framework for effective nonmarket management.
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9. After these setbacks, there is now a vibrant debate within BP about whether it makes sense to manage a conventional oil and gas business and a renewable business under the same corporate roof. Even though BP has cut back on new renewable investments, it has not changed its overall positioning, especially when it comes to climate change. See E. Crooks, "Back to Petroleum," *Financial Times*, July 8, 2009.
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