

# Nonmarket Strategy and Firms' Strategic Change

## Evidence from the China Telecommunications Industry

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*The research is financed by the Ministry of Education of China. No. 2006JDXM133.*

### Abstract

This study addresses a linking mechanism between nonmarket strategy, Austrian economics and firms' strategic change. Drawing on the results from a case study of China's telecommunications industry, we develop an integrative framework suggesting that telecommunications development and strategic change in China does not depend merely on economic growth, the nonmarket factors play a more significant role during this process. These results provide a strong incentive for future researchers to consider nonmarket strategy as a key variable in relation to strategic change success in transitional economies, which generates both theoretical and practical implications.

**Keywords:** Nonmarket Strategy, Austrian economics, Strategic Change

### 1. Introduction

In recent years, public policy scholars have attempted to integrate concepts of strategic management with the business-government literatures (e.g., Baron, 1995; Shaffer, et al. 2000), but it is fair to say that the two areas are treated as separate subjects by the academic literature. The current research draws from theories of strategic management and Austrian economics treat actions as sources of sustained competitive advantage. Previous business and policy researchers has generally focused on market-based actions, and not taken into account the social, political, and legal activities of the firm (Quasney, 2003). Clearly, nonmarket strategies, such as manage regulation, legislation, public affairs, media affairs and government relations, serve the primary objectives of firms to raising their market barriers, defending profit potential, and shaping and controlling their competitive environments, both market and nonmarket activities must be considered.

Therefore, our paper is an effort to fill this gap by exploring, both theoretically and empirically, nonmarket strategy performance in the literature. The telecommunication industry in China provided a uniquely appropriate setting for this study.

### 2. Theoretical background

#### 2.1 Nonmarket strategy

In the past several years a number of authors have begun to investigate the nonmarket strategy (e.g., Baron, 1995; Shaffer, et al. 2000). According to previous research, the notion of "nonmarket" strategy, which concern efforts to respond to and influence the political-economic-social environment, addresses the behavior of firms toward stakeholders and legal, social and political actors. This set of actors includes, but is not limited to the courts, regulators, trade authorities and legislators, the mass media, environmentalists, educators, public affairs specialists, and health professionals. Examples of nonmarket action include the lobbying, filing of antitrust law suits or administrative petitions, grassroots activities, providing testimony, holding a press conference or underwriting public broadcasting programming, issue advertising, publicizing a "green" campaign, organizing a political action committee, making political contribution or philanthropic donations, and sponsoring educational scholarships(Quasney,2003).

To date, no generally accepted nonmarket strategy exists. The literature suggests the following two distinct levels of nonmarket activity in business research. One level addresses the roles and motivations of firms to participate in the public policy process; a second level focuses on describing the general corporate political strategies firms pursue. Actually, strategic nonmarket actions are becoming more common occurrences in a period of rapidly increasing

corporate wealth, the view expands the strategic management theory with the core of market and competition. Firms should integrate nonmarket strategy with market strategy to realize the strategic goals.

### *2.2 The Schumpeterian Perspective*

The Austrian School of Economics, which has long argued that firms undertake purposeful action with an eye toward earning profits (Schumpeter, 1934), provides a broadened conceptual basis for this paper. The Austrian perspective emphasizes actions are implemented by entrepreneurs, or managers who discover a profit-making opportunity and are motivated to exploit that opportunity. Ferrier, et al. (1999) note that industries or market segments that generate excessive short-run profits will attract competitors also seeking excessive short-run profits. This market dynamic, in turn, will eventually lead to reaction by competitors that “imitate strategies known to generate above normal profits” (Jacobsen, 1992: 785), which subsequently leads to the washing away of the particular surplus profit of the industry (Schumpeter, 1950:31), erosion of advantage Ferrier, et al., 1999) and the loss of the incumbent firm’s level of strategic competitiveness, in a process described by Schumpeter (1934) as creative destruction.

## **3. Research Method**

In order to investigate the strategy change process in Chinese telecommunications industry, the case study method as a ‘research strategy’ (Yin, 1994) is preferred mainly because strategic issues are inherently contextual (Pettigrew, 1987). The Chinese telecommunications industry offered us a useful case for examining this aspect of nonmarket strategy and strategic change longitudinally.

### *3.1 Sample and Data Collection*

We conducted field and ethnographic analysis at five large organizations in the China’s telecommunication industry. Field methods are advantageous here because they provided rich data for theorizing and conducting a detailed analysis of the dynamics of interfirm ties. Table 1 provides descriptive characteristics of the sample.

### *3.2 Data Analysis*

We used the extended case method (Burawoy, 1991) as a guide to data analysis. This methodological approach uses empirical data gathered through case study to reconceptualize and extend theory. We began our analysis by working from the basic question, “how China telecommunication industry change has been successfully carried out by practically handling nonmarket factors?” This basic question allowed particular themes about control to emerge from our data that we could compare, revise, and refine as we collected more data and grew more familiar with the case. The result of our analysis is a four-part narrative about the four phases of the evolution of strategic change of China telecommunications industry.

## **4. Four phases of telecommunications development in China**

Telecommunication industry is one of the most dynamic industries in China. Before 1980s, this industry was dominated by a large number of state-owned enterprises (SOEs) and mainly focused on fixed phone set and some component manufacturing. Since 1980s, the industry has become the fastest growing one in China and in the world. Even in the dismal period after the bubble of .com collapsed in USA, telecommunication industry in China keeps its high growing pace.

Telecommunications development in China can be divided into four phases (see Figure 2): Centrally planned economy (1949–1978), slow growth (1978–1994), from monopoly to duopoly (1994–1998), and market liberalization (1998–present) (See figure 1).

### *4.1 Phase 1: Before 1978*

When the People’s Republic of China (PRC) was established in 1949, it only held the capacity of switch system with over 310 thousand lines, and 208,750 telephones subscribers, 620,000 telephones in the countryside and 2,000 long-distance lines, the national telephone density was only 0.05% and there were no rural telephones. (China Yearbook of Information Industry, 2000). So telecommunications, as a foundational industry, was very laggard at that time.

One major reason for the poor development of the telecom industry was that the government gave it low priority in its development plans between the 1950s and 1970s. The nation’s economic development priority was in heavy industry. Telecom services were used mainly by the state administrative agencies and regarded as part of the national defense and security system. The central planners regarded telecom services as non-productive and hence allocated more resources to other sectors with higher priorities.

Therefore, firms in China’s telecommunication industry before 1978 lacked autonomy and growth initiatives. They had no incentives to pursue such objectives as efficiency and profit. The only objective of these firms “tends to be...

fulfilling the plan quota and thus winning recognition from its administrative superiors” (Peng, 2000: 75). As a result, the whole industry operated with low efficiency. By the end of 1977, the telephone density was only 0.36%, increasing less than 0.02% every year. (International Telecommunication Union [ITU], 2001). When the Chinese government started its economic reform could call “act after trials” in 1978, it realized that the poorly developed telecommunication infrastructure had seriously deterred foreign investment and had acted as a bottleneck for domestic economic growth. To cope with this, the Chinese government started its telecommunication reform by changing its existing institutional framework and pushing firms toward marketization.

#### *4.2 Phase 2: From an Instrument to an Industry during 1978-94*

Since the beginning of reform and opening in China, the significance of telecommunications was recognized gradually. Central government leaders realized that domestic communications infrastructure and equipment could not meet the needs of a growing economy; the unsatisfied demand for telecommunication service was in fact acting as a bottleneck for the development of economy. In order to enhance the development of the telecom industry, the government gave high priority to this sector and carried out a series of policies, such as first-installation fee of telephone, in order to support the development of telecommunications. It was very important to the development of telecommunications afterwards.

Another important national strategies targeted at the sector was the ‘three 90 percents’ policy of 1982. It stated that: 90 per cent of central government investments put into telecommunications were not regarded as repayable loans; provincial and regional telecom authorities could keep 90 per cent of their taxable profits (in other words, the tax rate is 10 percent for telecommunication, much less than the 55 percent tax rate for other industries); and, the Ministry of Posts and Telecommunications (MPT), which regulated and managed both telecommunications operations and much of the nation’s telecommunications equipment manufacture, could keep 90 per cent of its foreign currency earnings from international traffic. (Wu and Zhang, 1992). At the same time, MPT began to actively introduce into foreign fund and modern technologies to drive the development of telecommunications. In 1982, the first SPC (Stored Program Control) Exchange in China was introduced into and installed in Fuzhou, which indicated the beginning of new period of telecommunication industry.

All of these favorable policies and huge investment had effectively accelerated the development of the telecommunication industry. The average annual growth rate of telephone mainlines between 1980 and 1994 was 21.58 percent, which was the highest in the world. In 1994, the telephone penetration rate reached 3.2 percent (ITU, 2001).

#### *4.3 Phase 3: From Monopoly to Duopoly during 1994 - 1998*

In 1994, the MPT announced that the basic demand for telecommunications had been met and the waiting list for telephone line installation no longer existed. To further ease the market transition, the Chinese government gradually withdrew the preferential treatment once granted to the telecommunication industry and opted to deregulate the telecommunication market.

The reforms were to introduce competition to the market for two purposes. Firstly, the domestic industry needed to provide better and more telecom services to Chinese customers. Secondly, local service providers needed to improve their competitiveness against foreign rivals for when China would open its domestic market to the world. Establishing China Unicom in 1994 was another step in the reform process, and created a duopoly competition in basic service areas. China Unicom was a joint venture with stockholders from the Ministries of Electronic Industry, Railways, and Electrical Power, and 13 other large state-owned corporations.

Simultaneously, as a first step toward separation from the MPT, the Directorate General of Telecommunications officially registered as a company called China P&T Directorate General of Telecommunications, which became known as China Telecom. The transition from monopoly to duopoly marked a breakthrough in China’s telecommunications industry. The entry of China Unicom into the market brought competitive elements into the telecom industry. Figure 2 shows the more complicated structure of China’s telecommunications networks at the end of 1998.

#### *4.4 Phase 4: Market Liberalization since 1998*

In many respects, 1998 marks a turning point in the telecom reform process taking place throughout the China. Before 1998, China’s telecommunication industry operated as a hierarchical structure. In 1998, the telecom Administration Bureau was founded, it is the regulator to the China Telecom market, which also independent to the operator and the manufacture companies.

The foundation of MII was a significant step in the establishment of a normal market environment for the telecommunications industry. But another problem was revealed. Compared with China Telecom, China Unicom

was too weak to compete with it fully, so even after the entrance of China Unicom; China Telecom still enjoyed actual monopoly profits. Then in mid-1999, another reform step was taken, which was to split China Telecom into four companies, each separately responsible for the operations of fixed telephony, mobile communications, wireless paging, and satellite communications. They are respectively called China Telecom, China Mobile, Guoxin Paging Company, and China Satellite. Guo Xin Paging was subsequently merged with China Unicom to enhance the latter's financial strength.

It is no doubt that the system reform of China's telecommunication regulation in 1998 will have a significant effect. The total turnover of telecommunications reached 584.1 billion RMB in 2005, increasing by 53 times more than 10.95 billion RMB in 1990. (See Figure 3).

The newly restructured regulatory framework has changed the whole industry structure. The MII became a relatively neutral regulator because there was no affiliation with telecommunication firms. This status has enabled the MII to take a more procompetitive stance and thus to facilitate competition in the Chinese telecommunication market. However, considering of the development of telecommunications in China and the challenge telecommunication operators will face, we should say that the reform should go further deep.

## 5. Discussion and Conclusion

This paper is the first, we think; to systematic analyze the China telecommunications industry strategic change from a nonmarket perspective. To our knowledge, no previous attempt has been made to examine industry strategic change process within the context of the nonmarket strategy. In the current study, an explicit attempt was made to merge the literatures on strategic change and nonmarket strategy. The outcome of our study indicates that telecommunications development and strategic change in China does not depend merely on economic growth, the nonmarket factors play a more important role during this process. These results provide a strong incentive for future researchers to consider nonmarket strategy as a key variable in relation to strategic change success in transitional economies.

This paper demonstrates that, subject to China's institutional endowments, the telecommunications change is identified with deep-rooted political involvement and frequent bureaucratic bargaining. China's telecommunications market of state competition made it easier for the government to restructure it thoroughly. In China, telecommunication reform has been a part of macro reform and national strategy of economy and politics, like joining WTO. The restructuring of telecommunications hence has been executed as section of a national policy of "strategic restructuring" and "optimizing national resources".

Our present study also makes important contributions to the literature. The current research moves beyond normative discussions about why firms should care about the role of nonmarket strategy (Baron, 1995), and will attempt to provide empirical evidence of the positive relationship between nonmarket strategy and industry-level change. With the relevant results, we hope to support the perspectives of business and society scholars, whose work emphasize the importance of nonmarket strategy to both business students and business practitioners.

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Table 1. A Summary of the Major Characteristics of the Sample during the Fiscal Year Ended December 2005

	China Telecom	China Unicom	China Railcom	China Netcom	China Mobile
Year founded	1994	1994	2000	2002	2000
Initial investment	158	16.92	10.3	60	51.8
Revenues	162.53	87.05	13.8	87.23	243.04
Number of employees	350,000	136,700	72,000	231,000	111,998
Name of the top leader	Xiaochu Wang	Xiaobing Chang	Jibin Zhao	Chunjiang Zhang	Jianzhou Wang
Headquarter	Beijing	Beijing	Beijing	Beijing	Beijing
Net profit	27.95	4.93	0.14	10.48	73.69
Total assets	412.57	142.63	58.3	300	421.03

Note: All amount units are billion RMB except Number of employees.

Source: China Yearbook of Information Industry (2005), <http://www.mii.gov.cn>

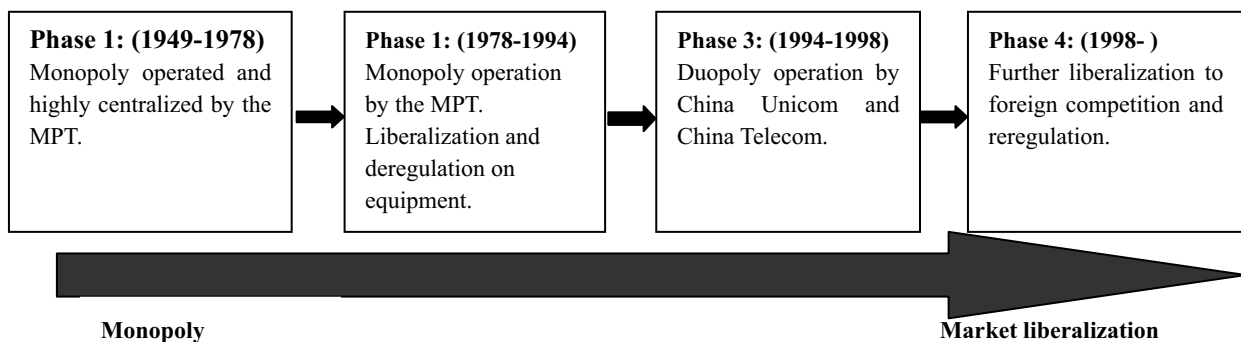


Figure 1. Regulatory Framework Evolution in China's Telecommunications Industry \*

\*: The MPT is the Ministry of posts and Telecommunications; the MII is the Ministry of Information Industry.

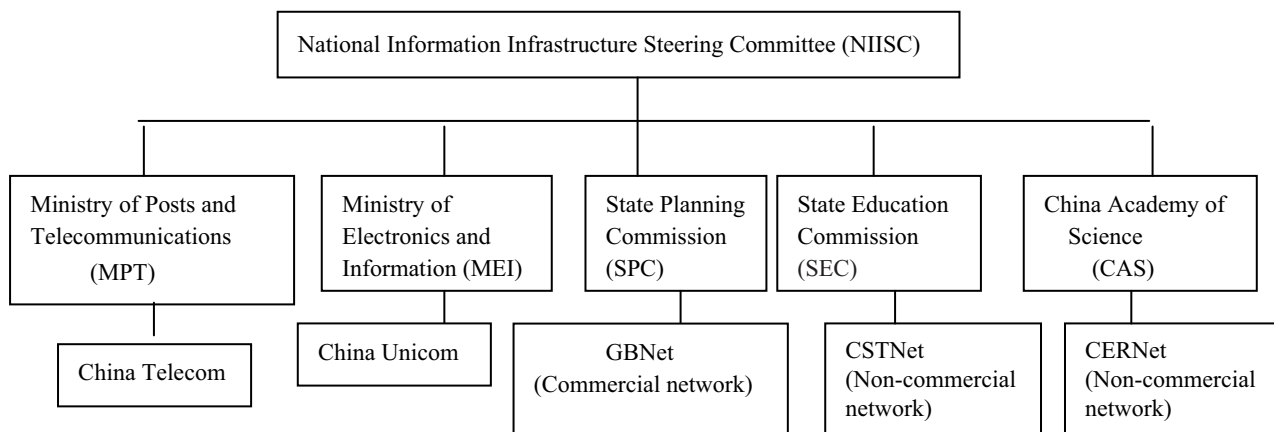


Figure 2. The Structure of China's Telecommunications Networks at the end of 1998

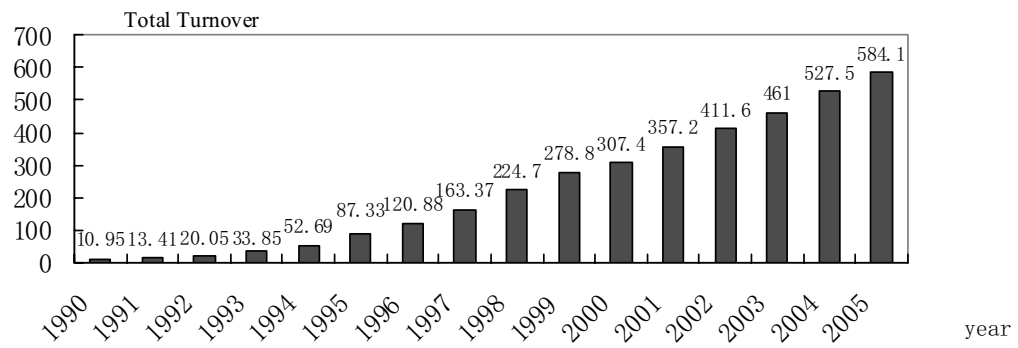


Figure 3. Developing Trend of Total Turnover of Telecommunications in China (In Billion RMB)