

# IS WHAT'S GOOD FOR BUSINESS ALSO GOOD FOR THE MARKET? PRO-BUSINESS AND PRO-MARKET POLICY DYNAMICS

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## Abstract

We build a process model in a new theoretical conceptualization of capitalist systems enhanced by new-institutionalist perspectives. Our rendering ultimately provides managers with a more tractable platform for decision-making than neoclassical models in economics, which largely ignore the role of government in setting the rules of the game. To construct our reconceptualization, we first define precisely what pro-business and pro-market policies underlying market-based systems look like at congruous levels of analysis. On that foundation, we build a process model illustrating pro-market tendencies within the business community, exploring their dynamics at different levels of product/service market maturity. Rounding out our reconceptualization, we recognize non-market actors typically omitted from neoclassical analyses and highlight the critical roles they play as pillars sustaining and supporting capitalist systems over the long run. We conclude with implications for managers and management education—as well as for the future of capitalism. In both the neoclassical paradigm and our enhanced rendering, managers remain self-interested; however, in our rendering astute managers ultimately seek positions that allow them to support market function rather than merely seeking positions that deteriorate market function as firms carve out ever more special privileges.

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*“What's good for General Motors is good for the country”*

- Charles Erwin Wilson (attributed)

[General Motors CEO during confirmation hearing to become US Secretary of Defense (1953)]

In the heyday of American manufacturing, the interests of big businesses, such as General Motors, were considered aligned with the interest of the country at large as well as those of the broader economic system. After the 2008 financial crisis, however, public trust in large corporations in America reached a nadir of 11% (in 2011) and currently hovers at a low 16%.<sup>1</sup> This lack of trust in big businesses has also spilled over to distrust in the broader capitalist system (Farooqar 2016): among young Americans, less than half hold favorable views about capitalism.<sup>2</sup> The schism in viewpoints widely held in the 1950s versus those widely held today has profound implications for managers and the firms they run reliant on the capitalist system for their very existence.

To what extent does the 1950s view—that government policies good for business are aligned with what’s best for the market (and the country)—actually hold true? Or, is the current scepticism of business and its role in a dysfunctional capitalism closer to reality? What explains the divergence in views over time?—and what factors drive alignment, or tensions, between firm objectives and markets ability to deliver societal benefits? Should we expect these more modern views to persist?—or is there little hope for the future of capitalism? Are the activist groups that target firms right to do so?—and are they really in opposition to a capitalist system or rather do they support it?

In this paper, we develop a process model that describes the conditions under which the interests of businesses tend to align (or diverge) with the interests of the broader markets in which they operate. We examine how this varies over time and the role of non-market actors as moderators. We make three major points while answering the questions above.

First, we argue that while natural tensions between *pro-business* and *pro-market* policies exist, which the literature has focused on (Rodrik and Subramanian 2005, Zingales 2009), that these are not mutually exclusive typologies. Taking the unit of analysis from a country level down to ones more relevant to business practice allows us develop this insight.

Second, we argue that while businesses *always* have incentives to remain self-interested with respect to policies they favor, that the nature of those policies varies over time. There can be limited conditions (phases) under which the *pro-market* concerns, and the *pro-business* interests of businesses become aligned. Taking cues from the industry lifecycle literature (Utterback and Abernathy 1975; Klepper 1997; Agarwal & Braguinsky 2015) juxtaposed against the better understanding we developed of *pro-business* and *pro-market* policies allows us to develop foundations for how this *pro-market* and *pro-business* alignment varies over time.

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<sup>1</sup> “With the Economy Recovered from the 2008 Financial Crisis, Chicago Booth/Kellogg School Financial Trust Index Shows Trust Restored.” Chicago Booth/Kellogg School Financial Trust Index 2019. <http://www.financialtrustindex.org>.

<sup>2</sup> “Democrats More Positive About Socialism Than Capitalism.” Gallup. August 13, 2018. <https://news.gallup.com/poll/240725/democrats-positive-socialism-capitalism.aspx>.

Third, and finally, we argue that contrary to popular perceptions that non-market actors, like Greenpeace, fight against the capitalist system, that they, in fact, do more to promote the capitalist system than firms, which are quite literally capitalists. Taking the social movements in business literature seriously (Baron 1995a, Davis et al. 2008, Freeman et al. 2010, King & Pearce 2010) when confronted with assumptions about preconditions for competitive markets allows us to develop this insight.

*Can market and business interests align? The institutional and managerial perspective.*

The neoclassical paradigm of “shareholder primacy” has considerable influence over modern businesses and the economic policy even in a world with imperfect competition. The neoclassical paradigm conceptualizes the capitalist free market system to be comprised of competing firms that are shareholder value-maximizing agents, where the goal of firm’s manager is generally “to make as much money as possible,” while conforming “to the basic rules of the society” (Friedman 1970). It suggests that rules of society that regulators set are likely to promote social welfare if there is competition among pressure groups for influence over regulators (Becker 1983). However, when political markets are “thin” (Henderson & Ramanna 2015) and competition between pressure groups is limited, it creates the risk of regulatory capture (Stigler 1971), where “rules of the society” (Friedman 1970, North 1991) may be designed in the interest of a few firms, to the detriment of the many. In such a captured market system, the neoclassical assumption that appropriate policies will align firm (pro-business) and market interests (pro-market) may not hold.

To understand policy in imperfect and captured markets, economists have used the pro-business and pro-market terminology at the country level as contrasting economic policies of governments that favor incumbents or competitive markets at particular phases of national development (Rodrik & Subramanian 2005, Zingales 2009). We add a managerial perspective, define pro-business policy at the level of firms and pro-market policies at the level of product-or-service markets in which firms operate, and argue that these two typologies need not be in contrast with each other in all cases. Such a managerial perspective provides managers with a decision-making toolkit that can help them identify aligned policies that support the market system, while also helping the firm’s long-term profitability—thereby overcoming time inconsistency problems.

By doing so, we address a gap in management literature where study of market systems has got less attention than it deserves (Barney & Rangan 2019), even though key market actors—entrepreneurs and managers—are the core unit of analysis for management scholars (Agarwal et al. 2009). Some papers have attempted more realistic descriptions of the market system (e.g., Ahuja & Yayavaram 2011; Henderson & Ramanna 2015; Dorobantu, Kaul & Zelner 2017) but they provide no recommendations, or else provide normative recommendations (Freeman et al. 2010) regarding managers’ responsibility beyond firm profits. To address this gap, we aspire towards a descriptive approach that details the conditions under which firms broadly are willing to have more pro-market tendencies.

*When can market and business interests align? The industry life cycle perspective*

We develop a process model to explore the conditions under which the tendency to pursue pro-market policies increases for incumbent firms. We extend the industry life cycle literature

(Klepper 1997; Agarwal & Braguinsky 2015), and argue that the life cycle approach can be a fruitful way of understanding the non-linear and cyclical variation in *pro-market* tendencies depending on the maturity stage of the product/service market the firms find themselves in. One of the key insights of the process model we develop is that firms pursue “good” pro-market strategies (Yao 1988) such as constant process innovation (Utterback and Abernathy 1975, Aghion et al. 2005) only in intermediary growth phases of markets when firms have an interest in expanding the size of their product/service markets even if such an expansion increases competition (e.g., Rajan and Zingales 2003), so that they can share a part of the growing pie.

In other phases of the market, firms are inclined to pursue anti-market policies, exploiting and undermining the same market system that collectively serves them. This creates a collective action problem (Olson 1982), a “tragedy of the commons” (Hardin 1968), and has stark implication for management scholars: as markets mature, markets are on path to cronyism, as firms are less inclined to pursue pro-market policies (Zingales 2017, Munger and Villarreal-Diaz 2019). If so, how can maturing economies stem the descent to cronyism that today gets reflected in the public sentiment (Farooq 2016)? We argue that non-market actors play a critical role in maintaining the health of the capitalist system, as market actors (e.g., incumbent firms) themselves may act as cronies.

#### *Critical role of non-market actors in aligning business and market interests*

The social movement literature and the stakeholder theory has highlighted the role of non-market actors in expressing “public grievances” against market outcomes (Baron 1995a, Davis et al. 2008, Freeman et al. 2010, King & Pearce 2010) such as carbon emissions from the automobile industry. Despite the visible role of non-market actors in influencing pro-market policies, they have not gained any centrality in the neoclassical, new-institutionalist or industry life cycle approaches of understanding markets and firm behavior. In this paper we address this gap. We argue that non-market actors perform critical market-related functions of reducing information asymmetry in markets, identifying externalities, and driving collective action, and hence in making markets more perfect (Debreu 1959). Without considering the unique functions of non-market actors in markets, our understanding of market systems is incomplete, as without them market systems will be unsustainable and prone to cronyism and capture by market actors, i.e., firms.

Overall our paper provides a richer description of how the market system and hence the capitalist system operates at multiple levels of analysis: with focus on managers, policymakers, and non-market actors. We argue that by fully considering all these actors of the market system, we can more clearly grasp what the market system looks like, how it operates, and how it might evolve in the future.

#### **DEFINITIONS: *PRO-MARKET* AND *PRO-BUSINESS* POLICIES**

Distinguished scholars in economics adopt the terminology *pro-business* and *pro-market* to describe the policy environment surrounding firms in market-based systems (see, e.g., Rodrik and Subramanian 2005 and Zingales 2009). In doing so, they follow a new institutional economics tradition by recognizing that the rules of the game (North 1991) matter. While outside the

discipline the terms *pro-business* and *pro-market* are sometimes viewed as synonymous,<sup>3</sup> their usage in the economics literature makes strong distinctions between the two constructs.

In the economics literature, this *pro-business* and *pro-market* language has been useful to help understand what factors help countries grow or what makes them stagnate. This language is also useful—as we will demonstrate—for management scholars and managers themselves who to date have not fully considered the concepts’ relevance to management research and practice. The utility of the definitions provided here extends beyond that of looser ones in existing work by pinning down the units of analysis and objective functions of such policies.

### **Existing Literature Employing *Pro-Market* and *Pro-Business* Terminology**

In the existing literature in economics, the terms *pro-market* and *pro-business* are conceptualized as what policy paradigms predominate at a country level to analyze long-run macroeconomic implications. For example: Rodrik and Subramanian (2005) use the terms to describe the Indian policy environment in different periods in an attempt to explain fluctuations in long-run growth within the country; Zingales (2009) uses them to assess risks and opportunities for the United States following the most recent financial crisis. This approach has been helpful when thinking about multiple markets making up a country and what the national tenor is at a given period of time—typically towards liberalization of multiple product and services markets simultaneously or towards protectionism favoring certain industries or firms.

Traditionally, the two types of policies are pit against each other to build a working understanding of what a *pro-market* or a *pro-business* policy might be. For instance, Zingales (2009) writes “serious tensions emerge between a pro-market agenda and a pro-business one.” Rodrik and Subramanian (2005) explain that if a policy is *pro-market* “it favors new entrants and consumers” while if a policy is *pro-business* “it tends to favor incumbents and producers.” If we embrace this conceptualization, then a given policy that is *pro-market* is necessarily not *pro-business* and vice versa—although we will return to this point as we consider the implications of the more precise definitions we develop and believe are more useful for understanding the dynamics of firms’ policy preferences in a capitalist system.

The existing literature in economics describes the archetypal *pro-market* policy as one, such as trade liberalization reducing tariff and non-tariff barriers, that increases competition in the marketplace and thereby moves markets towards an ideal conception of perfectly competitive markets. Meanwhile, the archetypal *pro-business* policy is one, such as increasing tariffs on products incumbents sell, that provides particularistic benefits to existing firms. Other archetypal *pro-business* policies include earmarked contracts to specific firms or tax breaks that only one firm can take in practice.

In general, there is a consensus among free market–oriented economists that they support things that are “*pro-market* not *pro-business*.”<sup>4</sup> It is difficult, perhaps impossible, to find any set

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<sup>3</sup> Kay (2009) notes that “both supporters and critics of the market economy often confuse policies that are *pro-business* with policies that are *pro-market*.” She continues by stating that “this confusion has undermined the social and political legitimacy of the market economy.”

<sup>4</sup> See, e.g., the final chapter of Zingales’s (2012) *Capitalism for the People*.

of thinkers who are staunchly *pro-business* all the time, although some economists interested in national growth do see a role for *pro-business* policies at times (e.g., Rodrik and Subramanian 2005). Even Milton Friedman (1962), with his normative shareholder primacy views, would not have advocated for *pro-business* policies, as he still believed that managers needed to stay “within the rules of the game, which is to say, [engage] in open and free competition without deception or fraud.”

The extant literature tends to discuss *pro-business* and *pro-market* policies at a country-level of analysis, aggregating towards general preferences or attitudes of a government at a particular point in time. This has produced some useful insights when thinking about the long-run macroeconomic performance of countries and its underlying drivers. However, aggregating to this level misses dynamics at the industry and firm levels more relevant to managers and management scholars.

Fortunately, the terms themselves actually give us guidance on what the appropriate levels of analysis might be, and can provide us with a litmus test for identifying and distinguishing *pro-business* and *pro-market* policies. The term *pro-business* contains the word *business* suggesting that we need to look to a *business* or *firm-level*. Likewise, the term *pro-market* contains the word *market*, suggesting we need to look at the *economic market* or *product or service level*. These levels of analysis can generate new insights for scholars seeking a paradigm of management behavior or a theory of tendencies in the policy environment surrounding firms’ activity in a given product-or-service market. To that end, we work from the following definitions, which provide us with a litmus test for identifying *pro-business* and *pro-market* policies.

We define *pro-business* policy, the following way:

A *pro-business* policy for firm *A* is a policy *X* that raises its long-run profitability.

*Pro-business* policies, under our definition, can grant individual firms carve-outs or special privileges from the government consistent with definitions in the extant literature. Note, however, that our definition is also more expansive, as it is certainly possible that firms could benefit from a given policy without that policy granting them any special privileges, simply because their unique resources or positioning in the market may allow them to better meet or exploit the new rules.

Note also that this definition does not necessarily imply that a given policy *X* is universally *pro-business*, as it is defined relative to firm *A* only. That means policy *X* does not necessarily benefit firm *B* or is *pro-business* from *Firm B*’s perspective. Different businesses have interests in subtly different policy outcomes contingent on their unique resources and positioning, yet much of the existing literature in both economics and political science tends to forget this (Hart 2004). It is actually quite difficult for a policy with heterogeneous effects on firms within an industry—a concept well accepted in the political economy literature (Salop & Scheffman 1983)—to be *pro-business* at a country or even a market level of analysis in which firms with different resources and positions compete against each other.

We define pro-market policy, in turn, the following way:

A *pro-market* policy is a policy *X* that moves its tradable product or service market towards *perfect competition* by ameliorating an *economic market failure*.

While this definition seems simple, applying it requires an understanding of the assumptions underlying *perfect competition* and an *economic market failure*. The conditions necessary for *perfect competition* are so exhaustive that it is virtually impossible to identify a perfectly competitive market in the real world: Economists recognize that this is “an idealized construct akin (say) to the mechanical idealization of a frictionless system or to the geometric idealization of a straight line” (Khan 1989). While managers operate outside of this theoretical realm, the lack of a perfectly competitive market in the real world does not obviate the utility of the construct. It is important to understand this theoretical ideal as it helps us understand what a *pro-market* policy looks like.

The economics discipline formalized the notion of perfectly competitive markets and proved in a mathematical model that as long as the conditions to produce such markets are met, we will achieve Pareto optimal outcomes, providing a basis for why we might prefer a pure capitalist system. In a perfectly competitive market, no exchange can be made where any party can be made better off without making another party worse off. Debreu (1959) lays out those conditions in his axiomatic mathematical model presented in his "Theory of Value":

- Goods are homogeneous.
- There are infinite numbers of buyers and sellers.
- There are secure, well-defined property rights.
- There is perfect and complete information.
- There are no externalities.
- Transactions are frictionless.

If any of the above conditions fail, then there are opportunities for either buyers or sellers to earn supranormal economic profits from exchange. Hence, as Yao (1988) points out, “failures of the competitive market are necessary conditions for supranormal profitability.” Importantly, in such a system, firms earn zero economic profits—which are distinct from accounting profits—and represent only the competitive market return on capital and labor being paid out to shareholders and workers. Yao (1988) points out the implications of operating in a perfectly competitive market for managers, writing “In such a world 'good' strategy is rewarded not with supranormal profits but with survival.” Hence, in a perfectly competitive market, definitionally absent the ability to lobby the government, firms engage in constant process innovation to survive (Aghion, Akcigit & Howitt 2014; Zingales 2017). Alternatively, entrepreneurs can focus on product innovation to start fresh in a new market with a new heterogeneous good and obtain first-mover advantages (Schmalensee 1982).

Importantly, when thinking about perfect competition, we need to be clear about market boundaries. Markets in an Arrow-Debreu world (Debreu 1959) are defined at a product level with a homogeneous products market. There can be disagreement over what a homogeneous product is: while commodities such as wheat or pork bellies are homogeneous products to most audiences, other products, e.g., internal combustion engine cars versus electric cars, raise questions. For the purposes of this paper, the relevant boundary of a market is a domain over which policies can be

enacted. For example, we would treat the electric car market differently from the internal combustion market if policies can be written specific to electric cars, but not directly about internal combustion engine cars.

The term *economic market failure*, in turn, does not mean the market fails to operate, but rather means that the market fails to achieve Pareto-optimal or social welfare-maximizing outcomes. Economic market failures are essentially analogs at a firm, market, or institutional level to assumptions of perfectly competitive markets failing. Table 1 lists different economic market failures in the fourth column; it includes such things as firms being able to pollute, firms holding private information, firms imposing transaction costs on buyers of using competitors' products (e.g., ATM fees), and barriers to entry (e.g., occupational licensing requirements). Economic market failures also can be more abstract, such as a lack of many buyers for a particular product or uncertain contracting regimes/enforcement—which are features of the market environment or the institutional environment in which firms operate over which managers have less direct agency.

Economic market failures are easier for a management—in particular a strategy—audience to understand than the notion of *perfect competition*, as without economic market failures firms cannot earn extra normal profits (Yao 1988). Moreover, economic market failures are not representative of a fictitious ideal like *perfect competition*, which can be troubling for managers who operate in a real world full of frictions that they observe and profit from on a daily basis.

### **Key Assumptions Underlying Perfectly Competitive Markets and Market Failures from a Management Perspective**

The key difference between a pro-market and a pro-business policy perspective is the unit of analysis, or who is doing the maximizing. Hence, *pro-market* policies are policies affect what economists call a *general equilibrium* world, where a “social planner” does the maximizing to achieve Pareto efficiency or conditions such that no party can be made better off without making another party worse off. On the other hand, *pro-business* policy perspectives place a particular firm at the center of the maximization problem and only consider outcomes that benefit that particular firm in what economists would call a *partial equilibrium* world, as it ignores what every other actor might do or how to bring the system itself to equilibrium.

Table 1 lists the assumptions underlying perfectly competitive markets as modelled by Arrow-Debreu (in column 1) juxtaposed against how these characteristics may deviate in reality via economic market failures (in column 4). In between we give examples of associated *pro-market* policies serving the Arrow-Debreu assumptions (in column 2) and *pro-business* policies preserving or creating economic market failures (in column 3).



**TABLE 1: Pro-market and Pro-business policy examples consistent with the extant literature vis-a-vis competitive market assumptions and market failure analogs**

<u>General Equilibrium World</u>		<u>Partial Equilibrium World</u>	
Assumption underpinning Arrow-Debreu Model	Pro-Market Policy Example	Pro-Business Policy Example (for incumbent firms)	Economic Market Failure
<b><i>Market Frictions</i></b>			
<ul style="list-style-type: none"> <li>No externalities</li> </ul>	<ul style="list-style-type: none"> <li>Pigovian taxes</li> </ul>	<ul style="list-style-type: none"> <li>Unlimited pollution by a particular firm or in manufacturing a particular product</li> </ul>	<ul style="list-style-type: none"> <li>Externalities allowable by incumbent firms</li> </ul>
<ul style="list-style-type: none"> <li>Perfect information</li> </ul>	<ul style="list-style-type: none"> <li>Disclosure laws</li> <li>Lemon laws</li> </ul>	<ul style="list-style-type: none"> <li>Corporate privacy laws such as non-compete agreements</li> <li>Laws protecting industrial data hoarding</li> </ul>	<ul style="list-style-type: none"> <li>Information asymmetry held by incumbent firm</li> </ul>
<ul style="list-style-type: none"> <li>No transaction/switching costs</li> </ul>	<ul style="list-style-type: none"> <li>Portability of consumer information/rights</li> </ul>	<ul style="list-style-type: none"> <li>Legality of transaction fees imposed on consumers for interoperability</li> </ul>	<ul style="list-style-type: none"> <li>Switching costs</li> </ul>
<ul style="list-style-type: none"> <li>Free entry and exit of firms</li> </ul>	<ul style="list-style-type: none"> <li>No occupational licensing (or fixed start-up costs)</li> </ul>	<ul style="list-style-type: none"> <li>Licenses required to enter</li> </ul>	<ul style="list-style-type: none"> <li>Barriers to entry for firms</li> </ul>
<b><i>Market Attributes</i></b>			
<ul style="list-style-type: none"> <li>Large number of sellers and buyers</li> </ul>	<ul style="list-style-type: none"> <li>Antitrust laws</li> </ul>	<ul style="list-style-type: none"> <li>Granting local monopolies via patents or other licenses</li> </ul>	<ul style="list-style-type: none"> <li>Monopoly firms</li> </ul>
<ul style="list-style-type: none"> <li>Product homogeneity</li> </ul>	<ul style="list-style-type: none"> <li>Standards setting</li> </ul>	<ul style="list-style-type: none"> <li>Poor enforcement of laws against false product claims (e.g., mislabeling products)</li> <li>Weak setting of standards</li> </ul>	<ul style="list-style-type: none"> <li>Product differentiation (along potentially artificial dimensions)</li> </ul>
<b><i>Institutional Function</i></b>			
<ul style="list-style-type: none"> <li>Secure and well-defined property rights</li> </ul>	<ul style="list-style-type: none"> <li>Unbiased enforcement of contracts (generalized)</li> </ul>	<ul style="list-style-type: none"> <li>Selective enforcement of contracts (particularized)</li> </ul>	<ul style="list-style-type: none"> <li>Poorly enforced or defined property rights</li> </ul>
<ul style="list-style-type: none"> <li>No regulatory intervention</li> </ul>	<ul style="list-style-type: none"> <li>Rules of the market are certain: well defined, apply generally and are unchangeable</li> </ul>	<ul style="list-style-type: none"> <li>Rules of the market are uncertain</li> </ul>	<ul style="list-style-type: none"> <li>Regulatory distortions in market</li> </ul>

The first four characteristics—externalities; perfect information; transaction/switching costs; and entry and exit costs—represent four market frictions, which are the subject of direct managerial concerns and fundamental problems that firms and/or regulators must deal with on a daily basis. *Pro-market* policies will attempt to minimize externalities (e.g., through Pigovian taxation), enhance provision of information (e.g., through disclosure and lemon laws), reduce transaction costs for consumers (e.g., requiring portability of mobile phone numbers across carriers), and removing licensing requirements (e.g., relaxing occupational licensing in professions where safety/professional standards concerns are minimal). Of course, incumbent firms can respond to these market frictions in multiple ways. One is to actively advocate or lobby for *pro-business* policies to keep the frictions in place or even enhance them—which is canonical rent-seeking behavior. The other thing that managers can do is try to create unique positions to profit from the frictions.

The items in the next two rows in Table 1—a large number of buyers and sellers, and product homogeneity—are marketplace attributes or market-level characteristics necessary for the ideal functioning of the *perfectly competitive market*. These are a little further from the daily concerns of managers and regulators and are closer to pre-conditions. *Pro-market* policies to deal with these, such as the appropriate enforcement of antitrust laws and the enforcement of standardization, will attempt to enhance competition and bring about homogeneity of products on critical dimensions (such as safety features or interchangeability).

The last two rows of Table 1—property rights and regulatory intervention—deal with institutional function rather than attributes of the marketplace. The key aspect of these institutional functions is that property rights, contract enforcement and regulation should be uniform and clearly stated, so that they do not create partiality and uncertainty in the marketplace. When governments dole out special privileges to firms or change policy frequently, creating policy uncertainty, such interventions and privileges create imperfections in the market system.

### **Reconsidering the Mix of Potential Policies**

Importantly, despite the appearances in Figure 1—and despite how economists have pitted the two terms against each other—*pro-business* is not a completely parallel term with *pro-market* because business represents a different level of analysis than the market. In fact, business is an actor within a market system, but not the only actor. (We will return to other actors later.) Hence, the level of analysis is much lower for *business* than it is for a given *market* (which is still smaller than a *country* containing many markets for many different products and services which may extend beyond its borders but beyond which may represent heterogenous products or services if location is an important dimension of a homogenous product).

Critically, we must recognize that each of these levels of analysis *can be* in tension with each other so that being pro-market does not necessarily mean being pro-business—as the existing literature in economics suggests. For example, liberalization of entry into a particular product or service market may introduce competition that hurts incumbent businesses operating in that market with inefficient production functions. However, these levels of analysis *can be* aligned as well. For example, consider the converse in the previous example, whereby firms that are more competitively positioned can do relatively better with more competition. Alternatively, firms that appear less competitively aligned when the market-based system fails to account for negative

externalities that a given firm has chosen to internalize become more competitive when the market-based system actually takes those negative externalities into account through regulations or Pigovian taxes. In such instances one set of firms benefits from the pro-market moves—and for those firms the pro-business and pro-market positions are aligned.

**TABLE 2: Pro-Market/Pro-Business Policy Alignment Matrix:**

**As pro-business policies are pursued at the level of firms, while pro-market policies that can heterogeneously influence firms are implemented at the level of markets, four possible scenarios can emerge:**

	Pro-market? Yes	Pro-market? NO
Pro-business? YES	<p><b><i>ALIGNED POLICIES</i></b></p> <p><i>Profit seeking by aligning firm to benefit from policies that would move the market towards perfect competition</i></p> <p>E.g. 1: Firms strategically position themselves such that they will make abnormal profits from <i>pro-market</i> policies that eliminate market failure. <b>Hewlett-Packard (HP)</b>, for example, lobbies for policy requiring competitor firms to internalizing negative externalities as it already had, in a way that has heterogeneous effects that raise rivals' costs (Fremeth &amp; Richter 2011; Richter 2019)</p> <p>E.g. 2: Growth markets where sharing protected intellectual property, for example, helps grow the size of the market and benefits the leading firms. <b>Tesla</b>, for example, gave away its IP on underlying electric car technology (Hu, Hu &amp; Yang 2016).</p>	<p><b><i>SELF-SERVING POLICIES</i></b></p> <p><i>Profit seeking by undermining competition/seeking special privileges</i></p> <p>E.g. 1: Special tax treatment for an activity that only a single firm conducts</p> <p>E.g. 2: Tariffs on competitors' products that do not affect a given firm</p>
Pro-business? NO	<p><b><i>MARKET-FORWARD POLICIES</i></b></p> <p><i>Eliminating market failures</i></p> <p>E.g. 1: Universal disclosure laws on used car sales for incumbents in the used car market</p> <p>E.g. 2: Antitrust enforcement for incumbent firms</p>	<p><b><i>OTHER MAXIMIZING POLICIES</i></b></p> <p><i>Primary aim is something other than making markets competitive or benefiting firms</i></p> <p>E.g. 1: Government-owned enterprises take monopoly control over an industry</p> <p>E.g. 2: Government-run healthcare systems</p>

Table 2 presents a two-by-two matrix illustrating these possibilities. For firms, pursuing policies that are anti-business is clearly not in their interest. Perhaps, however, firms need to be more careful about pursuing pro-business policies if the positions are not sustainable in the long run, even if they undermine competition in the short run. This time inconsistency problem will have implications for managers leading firms, because the market-based system will have pro-

market forces in it beyond the managers' own pro-business inclinations—including non-market actors, which we delve into later in detail after exploring dynamics without them playing an active role. In this sense there may be some incentives for firms to pursue what we call “aligned policies” that are ultimately both pro-market and pro-business simultaneously. We will dig into these dynamics after presenting our process model embodied in the pro-market policy cycle paradigm we present next.

## **DYNAMICS: THE BUSINESS COMMUNITY'S PRO-MARKET TENDENCIES AT DIFFERENT LEVELS OF MARKET MATURITY**

As noted in the prior section, firms and managers tend to pursue self-interested pro-business ends and the corresponding policies; however, at times we observe greater tendencies towards *pro-market* policy outcomes within certain industries. We also know that governments ultimately set the background institutions and rules of the game for how market transactions are conducted (North 1991). Therefore, we see greater tendencies to seek and accept the introduction of policies tilted towards pro-market orientations among firms operating in some product or service markets within countries at different periods than others. Why do we see these tendencies? What are the conditions under which firms either tolerate or embrace policies with a greater pro-market tilt to their specific sectors (or a greater pro-business and anti-market tilt to them)—and how does this evolve over time? Likewise, when do firms actively fight pro-market policies?

In this section we build a process model—visually illustrated as what we will call the pro-market policy cycle paradigm—in which we explore pro-market tendencies in aggregate among all incumbent firms within an industry at different levels of product or service market maturity. A better understanding of the relationship between the level of product or service market maturity and the corresponding pro-market attitudes and behavior of firms is relevant in at least three ways. First, it illuminates the type of institutions and public policies that are promoted and enacted at different levels of market maturity. Second, it provides valuable strategic insights for managers in their quest to maximize firms' returns and understand how alternative policies affect them. Third, without challenging the shareholder primacy view, it helps set up a need to clarify the role of non-market actors in nurturing and preserving free markets within a neoclassical framework, which we explore in the greater detail in the next section of the paper.

Our process model parallels and builds on the management and strategy literature on industry life cycles (e.g., Klepper 1997; Agarwal & Braguinsky 2015). As in that work, we are interested in the evolution over different industry phases and the underlying dynamics. Previous work focuses primarily on the number of firms active in the market and firm starts or firm deaths over the life cycle, largely as a function of innovation. Rarely, if at all, does the industry life cycle literature consider government policy towards industry in developing its hypotheses—which is the focus of our process model embedded in a pro-market policy cycle. Hence, our theoretical work can be thought of as adding an extra dimension to the neoclassical capitalist system that sits in the background of the types of industry life cycle models Klepper and others built, refined, and tested.

Similarly, our process model parallels work in Olson's (1982) book *The Rise and Decline of Nations*, which developed an “instant classic” theory of political economy (Heckelman 2007).

In this work, Olson explains how special interests' prevalence and increasingly pernicious and particularistic demands on government will eventually lead to "institutional sclerosis," thus slowing the economic growth of nations (Olson 1982). As a society starts reaching better levels of economic development and political freedom, coalitions tend to emerge. This includes distributional interest groups. At the margin, the activities of such groups tend to be more pro-business in nature. In Olson's narrative this can be a corrosive force for further economic progress and may even lead to the demise of nations' development; the very success of the democratic process in supporting the foundations of a neoclassical competitive market ultimately leads to its economic demise.<sup>5</sup> Unlike in Olson (1982), our main units of analysis are industries and firms rather than nations as a whole. This makes our process model embodied in the pro-market policy cycle relevant for the management and strategy literature. Moreover, it allows different markets to be at different points of rise and decline within a country at the same time when policies adopted are industry and industry-maturity specific.

### **Key Dimensions of the Process Model**

Our process model is graphically represented in Figure 1—and details on how the two primary axes are defined immediately follow. We then flesh out details on the three major transition points within it when the government is the only actor we consider outside of a neoclassical rendering of a market economy.

#### *Market Maturity*

On the horizontal axis we represent the level of product or service market maturity. The idea here directly parallels the horizontal axis in industry life cycle models. As such, we appeal to Williamson (1975, pp. 215-216) and Klepper (1997), who identify three stages of industry maturity: an early exploratory stage, an intermediate development stage, and a mature stage.

- In the exploratory stage, the product or services on offer and associated technology and processes are primitive, characterized by low volume and a high degree of uncertainty.
- In the intermediate development stage, there is a rapid expansion in volume, as product or service improves and the technology or processes needed to produce it are refined.
- In the mature stage, volume growth slows down as product or service matures and innovation and process improvements reap small rewards.

During the growth stage, the market is attractive and draws entry of new firms and growing competition. As a market matures, it becomes less attractive, with slowing growth, firm entry, and competition. Note that the inflexion point does not aim to represent a perfectly mature competitive market, but a point at which the overall tendency towards pro-market policies tend to reach its peak.

#### *Aggregate Pro-Market Tendencies among Incumbent Firms*

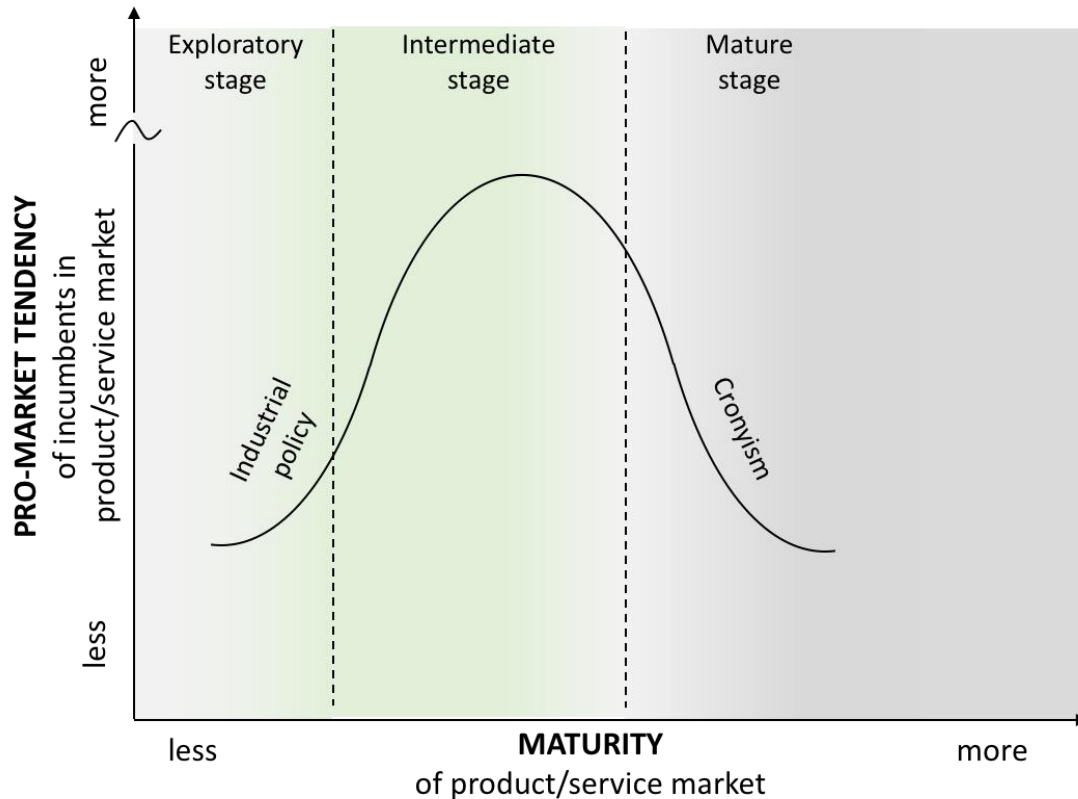
On the vertical axis we represent pro-market orientation in aggregate among incumbent firms operating within a product or service market. Hence, we can interpret higher values along this axis as more firms in a given product or service market being willing to promote and accept

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<sup>5</sup> This echoes Madison's (1787) concerns about factions in *Federalist Number 10*

pro-market policies. As defined in section two, by pro-market we mean policies that move the market towards perfect competition and reduce market failures. Policies that minimize externalities such as pollution, improve information access, increase competition, promote standards, reduce transaction and switching costs, ensure generalized property rights and contract enforcement, and provide policy certainty are some of the examples of such pro-market policies. Beyond firms, which may have a preference for specific market-level policies (e.g., automobile manufacturers favoring certain emission standards), governments and regulators are key actors here, as are private institutions like industry consortiums (King, Lenox & Terlaak 2005; Dorobantu, Kaul & Zelner 2017; Pritchett, Sen & Werker 2017) that aggregate policy preferences.

**FIGURE 1: Pro-Market Policy Cycle**



**Phases of the Pro-Market Policy Cycle Paradigm**

We expect that firms with *pro-market* orientations seek “‘good’ strategies” (Yao 1988) that, as discussed in section two, involve continuous process innovation, which makes them competitive in the market without creating market failures. The process innovation aspect is crucial in our narrative. Utterback and Abernathy (1975) describe the rate of innovation in different industry stages:<sup>6</sup>

<sup>6</sup> Klepper (1997) notes that different authors in the lifecycle literature use different terminologies for the various phases and may have more than the three phases presented here. E.g. at least one popular text (Hill & Jones 2008) describes there are being five stages of evolution: embryonic, growth, shakeout, maturity, and decline. For our purposes the three stages above suffice as do Utterback and Abernathy’s explanation of them.

- Exploratory, less mature markets are those with relatively primitive products or services, and, by definition, they are the arenas of high product innovation, as they are characterized by new products. As the market matures, the rate of product innovation goes down. By undertaking product innovation a firm can seek profits by creating new markets and seeking early-mover Schumpeterian rents.
- As markets mature to the intermediate stage, there exists a greater scope for process innovation such as improvements in manufacturing or expanding supply chains. Such process innovation is lower in the exploratory stage when technology and processes are more uncertain and less developed. Hence, with increasing product (or service) maturity and sales growth, the rate of process innovation is expected to increase.
- Finally, process innovation continues until the market reaches the mature stage, where sales volume growth declines or stabilizes, market share is settled, and the return from such innovation is reduced. An inflection—where process innovation begins to decline—may begin when (counterintuitively) markets reach high levels of competition and hence marginal gains from innovation are reduced (Aghion et al. 2005). As mentioned previously, while we call markets in this stage “mature,” it certainly does not mean they are fully or perfectly competitive in a neoclassical sense, reaching some fictitious ideal. What the *pro-market* policy cycle paradigm captures rather is where and how markets evolve from a primitive stage to a more mature one, as well as the potential consequences of such evolution.

Now we can elaborate on the firm-level dynamics in the *pro-market* policy cycle represented in Figure 1.

#### *Exploratory-Stage Markets and Embrace of Industrial Policy*

In the first stage labeled “industrial policy” in Figure 1, firms’ are in the exploratory stage of producing and selling primitive product/services in limited volumes. Two such exploratory markets are commonly found. All markets comprising new, innovative, yet unproven technology products and services are examples of exploratory markets (e.g., electric vehicles). Additionally, in emerging-market countries, even basic services (such as banking or retail) may be in a nascent and exploratory stage with low volumes even if the market is not driven by any product innovation. Given the small size and uncertainty of exploratory markets, incumbents would have limited room for coping with intense competition, and returns from process innovation will be limited in such nascent markets (Utterback & Abernathy 1975). Hence, they are unlikely to exhibit a *pro-market* orientation and instead are likelier to seek protections. In technology-intensive markets these protections may take the form of stronger protection of their know-how (e.g., through patent thickets), while in emerging markets such protections may be in the form of infant industry protection. This yields our first proposition derived from our process model:

***Proposition 1:*** In markets’ exploratory stage, we will observe relatively low *pro-market* attitudes among incumbent firms, as firms operating at this stage particularly value policies that will help them resolve uncertainty about their investments in product innovation efforts as they establish basic industry architecture to scale up in the next phase.

Policies that help firms establish basic industry architecture (Pisano & Teece 2007) and/or resolve uncertainty about their product innovation investments are often *pro-business* for firms.

Such policies tend to serve to subsidize consumer interest in the products or services incumbent firms are offering. Policymakers may be amenable to such policies that protect firms from external competition if they see it as protecting an infant industry. The policies may thus be couched as industrial policy (Harrison & Rodríguez-Clare 2010; Stiglitz, Lin & Monga 2013), where government industrial policies can be a major source of competitive advantage for firms (Lazzarini 2015). However, it is important to note here that, for markets to mature, with more firms entering and engaging in competition with incumbents, such protections can only be temporary (Tullock 1975), as otherwise the market may remain stuck in a transitional gains trap. The limited timeframes on patent protections allow the transition to the next phase of market maturity to occur by avoiding Tullock's transitional gains trap.

In less mature emerging economies (with less mature product/service markets), pro-business protectionist policies have been embraced by policymakers. Examples of such public policies are import substitution programs or infant industries protection strategies, such as in India's retailing industry in the 1980s (Rodrik & Subramanian 2005) and the textile industry in Mexico in the early and mid-1900s (Gómez-Galvarriato 2007). Similarly, Pritchett, Sen and Werker (2017) argue that "deals" between firms (or their associations) and governments in emerging markets play an important role in sustained economic growth, in contrast to the neoclassical approach, which is driven by "rules."

In the exploratory stage, profits are tied to the existence of such protections. For example, patent protections may serve as a form of industrial policy protection for inventors of new products by giving them the legal rights to operate a government-protected monopoly, albeit for a limited time horizon. In the absence of protection from the gales of market forces, a given firm's ability to compete based solely on its initial value creation by virtue of having developed a new product market space is limited.

If protections stay in place indefinitely, such protections can stunt market growth (e.g., in the financial industry (Rajan & Zingales 2003)). However, we argue that as the market matures, incumbent firms are likelier to seek policies that favor market growth, even though it increases competition, because in intermediate stages of market development, firms can pursue "good" strategies (Yao 1988), such as process innovation, to maintain competitive advantage.

#### *Intermediate-Stage Markets and the Move towards Perfect Competition*

In the second or intermediate development stage of markets, product uncertainty has diminished and the focus of the industry is growing sales. Pro-business interactions (welcome during the exploratory industry stage) become less effective in sustaining growing profit levels for incumbent firms if the growth of the market size overall stalls with such policies in place. Moreover, sufficient market scale may not be achievable if such policies persist indefinitely. Hence, pro-market policies become more attractive to firms (or at least less unattractive) in the intermediate stage given that their managers are primarily interested in overall market growth. Firms in such growing markets typically hope to maintain or grow their share in expanding markets through a greater emphasis on process innovation.

As products and technology mature and the market expands, firms are able to gain competitive advantage through process innovation related to operational efficiencies (Utterback &



Abernathy 1975). This shift towards process innovation is also aided by products becoming more homogenous, and technology and processes become more established in this industry stage (Klepper 1997). As firms seek larger scale, adoption of pro-market strategies such as standardization also becomes more desirable (King, Lenox & Terlak 2005), which further propels gains from process innovations such as streamlining the supply chain.

***Proposition 2:*** Incumbent firms in the intermediary growth stage of an industry will have a greater tendency to accept pro-market policies that become more attractive to firms interested in growing the size of the market (even if their share of the “market pie” stays relatively fixed).

Incumbents in such growing markets are likely to accept pro-market policies even though these policies open up more competition, as they expect that the size of the market captured is still large, even if it is a smaller share of a growing pie. Rajan and Zingales (2003), in their analysis of the willingness of financial incumbents to favor arm's length markets (reducing transaction costs), make a related argument: the opposition of financial incumbents to opening of arm's length markets will be most muted when trade and capital flows increase with the opening of the country's borders to both trade and capital. They argue that, in less mature (exploratory) stages, financial incumbents will oppose such pro-market reduction of transaction costs. Firms in these moderately competitive markets resort to innovation (Aghion et al. 2005). Chari and David (2012), studying Indian firms, find that although pro-market reforms reduce profits, firm investments in innovation (through research and development) and in marketing and advertising act as a protection against the erosion in their superior profits in the pre-reform phase.

An alternate way that the industry phase could move from the exploratory stage to the intermediate development stage is that non-incumbent market actors may begin to demand the end of special privileges the incumbents enjoy and the insertion of the industry in a global competitive arena. For example, firms in the Mexican textile industry eventually had to open to external competition mainly because China became more competitive and started accessing not only attractive markets like the US and Europe, but also the Mexican market, displacing inefficient domestic firms (Gómez-Galvarriato, 2007).

Useem (1978) suggests another mechanism for making managers of larger firms in an “inner group” of the “capitalist class” more likely to have a “general class consciousness” and accept pro-market-type policies. Useem argues that such “inner group” executives have a greater likelihood of exposure to broader concerns of the business community and society at large via having a stake in a diverse set of firms, potentially across industries (for example, through board interlocks) or even exposure to governmental concerns (for example, through serving on public-private commissions or in the public sector via revolving doors). Executives only from incumbent firms in accepted industries, i.e., those at an intermediate development stage or beyond, are likely to sit in such positions. Moreover, the reasoning becomes even more stark when considering the potential distributional concerns of executives with stakes in more than one policy outcome because they are tied to both a firm that benefits from a particular pro-business policy as well as another firm that suffers from the same policy.

The willingness of firms to support pro-market policies is related to the growing size of the markets, and when returns from process innovation are large (Utterback & Abernathy 1975; Aghion et al. 2005). These tendencies among firms in the industry hold until an inflexion point is reached. Importantly, this point where pro-market tendencies of firms peak, while representing perhaps the closest thing to the theoretical ideal of perfect competition discussed earlier, likely falls far short, as in reality there will still be some economic market failures mostly in the form of market frictions from a managerial perspective (i.e., relating to externalities, information asymmetry, and transaction costs/barriers to entry).

### *Mature-Stage Markets and the Decline into Cronyism*

Once an industry is at a more mature stage, profits tend to dissipate and the marginal returns of even process innovations decline (Utterback & Abernathy 1975). This occurs towards a peak where firms tend to copy each other's innovations (Utterback 1974). At some point the marginal returns to innovation are lower than the potential returns to lobbying for special privileges, thus coming back to a policy orientation tilted in an *anti-market* direction. We now move to a world where "nobody has a special interest in keeping the market competitive" (Rajan & Zingales, 2004). As incentives to innovate (within the product/service market) decline, the strategies that gain prominence in the mature stage of the market are less likely to be pro-market and are more likely to be rent-seeking in nature (Ahuja & Yayavaram 2011), such as lobbying for special privileges (Zingales 2017).

**Proposition 3:** In mature-stage markets, firms will lean away from pro-market policy preferences given the marginal returns of process innovation will eventually decline to a point where it becomes harder to obtain above supernormal profits by innovating rather than securing special privileges from the government to advance firms' competitive positions.

The integration of a firm or industry in a more mature market yields profits until more and more competitors enter the same market and the benefits of openness and more competition start dissipating. In the segment to the right of the inflexion point, the special privilege is related to cronyism rather than special industrial policy. Instead of hiring engineers to innovate (Utterback & Abernathy 1975), firms may find it more attractive to invest their marginal dollars in lobbying. It becomes more profitable to lobby for *pro-business* policies and try to obtain special privileges rather than innovate and compete. Entrepreneurial efforts and energy are diverted to seeking profits not by presenting value creation propositions to consumers, but by seeking rents from regulators. In fact, some argue that there may be a natural tendency within free markets in liberal democracies towards that path (Munger & Villarreal-Diaz 2019).<sup>7</sup>

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<sup>7</sup> Taking this to an extreme beyond simply corporatism, Holcombe (2018) advances the concept of "political capitalism" defined as "an economic and political system in which the economic and political elite cooperate for their mutual benefit." In this framework, firms and economic elites influence the policy-making process (mainly regulation, government spending, and the design of the tax system) to maintain an economic advantage over potential domestic and external competitors, and managers become rent-seekers even at the expense of value-creation propositions for consumers. Whether the public and public interest will tolerate such outcomes is an open question.

## **Tracing the Pro-Market Policy Cycle Paradigm through the US Automobile Industry**

To illustrate more comprehensively the arc of the pro-market policy cycle, we follow the evolution of the US automobile industry, which has also been studied by papers related to industry life cycles (Raff 1991; Klepper 1997; Argyres & Bigelow 2007, 2010; Bigelow & Argyres 2008). Here we provide an analysis of the policy background related to the US automobile industry development and maturation to help illustrate different phases of the pro-market cycle.

### *Exploratory Stage and Strong Pro-Business Embrace of Complementary Infrastructure*

Due to the product uncertainty and uncertainty surrounding the viability of a market for the new products in the exploratory stage, our pro-market policy cycle paradigm (Figure 1) predicts that firms at this phase will not be inclined towards pro-market policies and seek industrial policies that protect and subsidize them to make the market more viable (Proposition 1). Looking at the US automobile industry, we can examine whether this was true. The US auto industry went through an exploratory phase from roughly the 1880s, when American manufacturers copied European designs, through approximately the 1930s. One prominent example of a pro-business industrial policy that firms certainly enjoyed in this stage was planned federal support in roads and highway construction, the Federal Aid Road Act of 1916, followed by the Federal Aid Highway Act of 1921.

The industrial policy of building roads and highways received popular political support, as it helped those in more rural parts of the country get to more urban centers and markets. Despite popular support, the Federal Aid Road Act (1916) and Highway Act (1921) are examples of an industrial policy that made particularistic and privileged transfers from the US federal government to existing firms in the automobile industry (rather than generally to other industries). It helped firms in automobile manufacturing by funding the paving of roads around the US, providing an infrastructure to allow cars to operate more smoothly than they could on the existing network of dirt paths—and improving the prospects for performance of automobiles as a mode of transportation. In fact, during this exploratory stage for the automobile industry, Alfred P. Sloan, then president of General Motors, founded the American Highway Users Alliance in 1932, an advocacy group whose goal was to ensure continued, sustained federal government spending on highway construction and repair. Thus, major industry incumbents had already begun to actively lobby for privileged and protectionist positions.

Such particularistic policies came as a relative transfer away from other infrastructure-type products such as railways and streetcars. For example, the electric streetcars in US cities that were a salient form of urban transport in the early 20<sup>th</sup> century began to decline from the 1920s (Fan 2017). While such a decline could be driven by a customer preference for road-based transport (buses) the period also saw a concerted effort by automobile and oil companies (most notably National City Lines (NCL)) to replace streetcar (rail) with bus- (road-) based urban transport, culminating in the General Motors Streetcar conspiracy, where NCL and its backers, including General Motors, were accused of monopolist and anti-market practices in the 1940s.

### *Intermediate Development Stage and Pro-Market Movement to Safety Standards*

During the intermediate development stage, the Pro-market Policy Cycle Paradigm predicts that incumbent firms in an industry will tend to embrace (or at least not put up active resistance to) policies that are more *pro-market*. At this stage, major product innovation is complete—and firms have a great deal to gain by focusing on ramping up mass production of an increasingly known and accepted product. In the US auto industry, this phase lasted from roughly World War II through a production peak in the early 1970s. It was during this period that GM CEO Charles Irwin Wilson proudly testified about how “what’s good for GM is good for America,” suggesting that his belief, at least, was that there was alignment between the firm’s business interest (in pro-business policies) and the social welfare of the country served by the automobile markets his firm focused upon (pro-market policies).

During growth phases, like the heyday of US manufacturing in the auto industry, growth of sales in the industry at large was the broader managerial goal, and competition moved towards process innovation. To grow the market overall, trust in the industry becomes essential. Hence, as predicted by the pro-market policy cycle paradigm, managers are more willing to accept policies that reduce information asymmetries with customers (about what safety products are effective), that reduce negative externalities (such as fatalities from auto accidents), and increase standardization and homogeneity of products along some critical dimensions related to reducing economic market failures. Within the auto industry all of these efforts to eliminate market failures were present, embodied in the first safety standards that applied to auto manufacturers being legislated in 1966 via the *National Traffic and Motor Vehicle Safety Act*. The law led to the first regulations requiring new cars to have seat belts, effective in 1968 via the brand-new regulatory agency, the National Highway Transportation Safety Administration. The result of these pro-market policies that created seat belts as a standard feature was to reduce the increasing epidemic of auto-related injuries (a negative externality from automobiles as a product).

Moreover, prior to the policies’ enactment, some industry leaders voiced a willingness to see the government begin to regulate auto safety standards. For example, Harry E. Chesebrough from Chrysler testified to Congress in July 1965 on how the firm “became so convinced of the value of seat belts that it made them available to dealers on a non profit basis,” eventually offering them as standard equipment, but needed help from the government to get drivers and passengers to use them more broadly, as “only 42 percent of all drivers have cars equipped with seat belts” but usage rates were low.<sup>8</sup> Unsurprisingly, support from firms that manufactured seat belts was higher from suppliers of such products than the auto manufacturers themselves—as evidenced in Congressional testimony by Erle Cocke from Safety Systems, Inc, which followed that of Chesebrough from Chrysler in July 1965 (Government Printing Office 1966). This is unsurprising given the pro-market policy in the completed-automobile-to-consumer market had a decidedly pro-business tilt for incumbents in the still-exploratory-stage seat belt supplier market.

Fixing standards within the automobile industry by requiring (at least across-the-lap) seat belts served as a pro-market policy because it created greater homogeneity in automobiles, helped industry and government reduce information asymmetries around auto safety, and reduced

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<sup>8</sup> Traffic Safety: Hearings Before the Committee on Commerce, United States Senate, Government Printing Office, 1966. <https://books.google.co.in/books?id=kSM3AQAIAAJ>

negative externalities (deaths) from product use. Auto industry executives of incumbent manufacturers were willing to accept changes in this area to improve trust in the industry overall and increase the total number of auto sales as they focused their competitive efforts on process innovation.

### *Mature Stage and Descent into Cronyism with Pro-Business 'Bailouts'*

The US automobile manufacturing industry entered its mature stage in the 1970s, where, consistent with characterizations from Utterback and Abernathy (1975), competition began to center on production efficiency—with which we saw the rise of Japanese firms noted for their “lean” techniques (Cusumano 1988). At this stage, even the returns to process innovation were low. Hence, the major US-based automobile manufacturers struggled. Given their structural inability to retool plants and processes along the lines of the innovations that came from the Japanese plants, the major US automobile manufacturers—while large—entered a phase where the returns to efforts to gain special privileges perhaps exceed those of process innovation. US government financial support of Chrysler in 1980 via the *1979 Chrysler Loan Guarantee Act* and to both GM and Chrysler in 2009 through the *Troubled Asset Relief Program* (see Fremeth, Holburn and Richter 2016) embodied such special privileges, as the automobile manufacturing industry, at least for incumbent firms with internal combustion engines, descended into cronyism.

Seeing that process innovation was unlikely to succeed, Lee Iaccoca, shortly after his appointment as Chrysler president and CEO in 1979, went to Washington and appealed for help to protect the firm from going bankrupt and succeeded in framing appeals (Bach and Blake 2016) on national pride and providing continued jobs in politicians' districts. Of course, the real motivations were pro-business, as the once-dominant firm, unable to make necessary process innovations, had lost its competitive edge.

### **ADDING MORE COMPLEXITY: NON-MARKET ACTORS IN MARKETS**

The current neoclassical paradigm focuses on market actors (firms) and government (regulators) in the functioning of markets but ignores the role of non-market actors such as the media, non-governmental organizations (NGOs), public interest litigators, and academic experts. In an economy where governments are perfectly driven by public interest or there is competition between pressure groups (a “thick” political market) that pushes policymakers to act in the public interest (Becker 1983) as the issues are “widely salient” (Bonardi & Keim 2005), the current neoclassical paradigm can work well without the need to consider additional actors. However, this paradigm ignores the historical reality that governments often act in nexus with businesses (Ogilvie 2011, 2019; Zingales 2017) and that many political markets (Bonardi, Hillman and Keim 2005) themselves have been “thin” (Henderson & Ramanna 2015).

Firms in a competitive environment maximize profits by positioning themselves in a manner such that they can seek rents (Ahuja & Yayavaram 2011). Ideally such a rent should emerge from innovation, as it expands the productivity frontier, offers more features to customers at lower prices, and also benefits the innovating firm. Growing markets (in the second stage of the

pro-market policy cycle) may provide firms the space to pursue such innovative strategies. However, in a highly competitive market (in the third stage of the pro-market policy cycle) firms have little incentive to pursue such innovations (Utterback & Abernathy 1975, Aghion et al. 2005). To maintain competitive advantage in such markets, firms can pursue non-market strategies such as lobbying to capture regulators and enact (remove) regulation that disfavors (favors) competition. If regulators are captured, then such capture has no market-based or regulatory cure. Such a pro-business strategy can stifle competition, create monopolies, and at the same time make regulatory measures like antitrust ineffective. In such an imperfect setting, non-market actors begin to play a central position in sustaining a competitive market. In this section we elaborate on their role.

### **Who Are Non-Market Actors?**

The threat of monopoly power has long been a salient topic for economic and political thinkers. Adam Smith, in his book *Wealth of Nations* (Smith 1776), was highly critical of “the wretched spirit of monopolies.” To deal with monopoly power, historical figures like Thomas Jefferson believed in a more hawkish approach of enshrining “restriction against monopolies” in the American Bill of Rights. However, Jefferson's counterpart James Madison emphasized the role of democracy<sup>9</sup>, “literary works and ingenious discoveries” in reining in the “nuisances” of monopolies. In a scenario where regulators are captured by incumbents, Jefferson’s protections against monopolies may not be effective (as these restrictions are to be enacted by regulators themselves). Hence, a Madisonian world where non-market actors (“power in the many”) act as a check against the anti-competitive actions of firms becomes crucial. The importance of “public grievances” against market outcomes (King & Pearce 2010) in sustaining the health of markets has also been emphasized by scholars who study the role of social movements in organizations and markets (Davis et al. 2008).

Baron (1995a), in his classic article on the nonmarket environment, includes “the public, stakeholders, government, the media, and public institutions” as actors that intermediate interactions in the nonmarket environment. Government (regulators and policy makers) has been considered to be a distinct component of the market system in the neoclassical and new-institutionalist paradigms. Hence, the *public*, *stakeholders* (e.g., environmental and civic rights groups), the *media* and *public institutions* (e.g., universities) are entities that can be called non-market actors in our conception.

Given the broad list, it is important to specify who does not constitute a non-market actor. If we conceptualize a market to be comprised of multiple competing firms that produce a single good, then the suppliers of the inputs (raw materials, capital, and labor) of production and the consumers of the produced good have a direct influence over the firms. Hence, suppliers (including workers) and customers cannot be considered to be non-market actors. Associations of actors that directly relate to the market (like trade associations, labor unions and consumer interest groups) could be market or non-market actors, depending on how directly they represent the interests of actors associated with a particular market. A labor union comprised of workers from different industries may be considered a non-market actor, while a union of workers from a particular market may be considered less so.

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<sup>9</sup> “Where the power ... is in the many, not the few.”

Non-market actors can perform some very specific functions of reducing market frictions. There are two distinct channels through which non-market actors accomplish this. Firstly, non-market actors (like the media) can reduce information asymmetry and expose externalities by unveiling information necessary for the functioning of markets (e.g., quality). Secondly, non-market actors enable collective action. "Thin" political markets with less competition between pressure groups lead to worse policy outcomes (Becker 1983; Henderson & Ramanna 2015). For example, Paik, Kang and Seamens (2019) find that new innovations (like ridesharing) are more likely to be banned to favor incumbents if political competition is low, and this effect is larger in smaller cities with low unemployment rates. Hence, non-market actors (like environmental groups) can help organize fragmented stakeholders together to demand specific policy goals that minimize market externalities such as pollution. By performing these functions these non-market actors play a central and inimitable role in sustaining competitive markets—and in many ways do more to support the function of the capitalist system than do firms. Without understanding non-market actors roles our understanding of market systems remains incomplete.

#### *Non-Market Actors Reduce Information Asymmetries and Expose Externalities*

One of the most influential non-market actors is the *media*, which plays a key role in reducing information asymmetry between market actors and the public, and hence influencing firm decisions (Durand & Vergne 2015; Tan 2016). Media, such as muckraking journalism in the US in the early twentieth century, can wield considerable influence on regulation (Dyck, Moss & Zingales 2013). The muckraking era of journalism (1902–1917) was a period in American journalism when a rise in investigative journalism especially exposed corruption and other malpractices in business. Dyck, Moss and Zingales (2013) showed that US “representatives voted differently on regulatory issues that were previously exposed in muckraking magazines, the more so the more diffused were muckraking magazines in their districts,” highlighting the importance of media and especially investigative journalism for institutions and regulation. A salient example of such "muckraking" journalism was the 1906 exposé of Chicago's meatpacking industry's unhygienic conditions by Upton Sinclair's work *The Jungle*, which directly resulted in the establishment of the institution now known as the US Food and Drug Administration (Moss and Campasano 2016).

Information asymmetry can cause significant public harm. As firms may be in a better position to discover the negative externalities of their own products, there are limitations to how often media can expose them. Revealing publicly beneficial information about the harms of a product that a firm profits from presents a moral hazard. US chemical manufacturer DuPont faced this moral hazard in the early 1980s, when it knowingly understated the negative externalities of its profitable product Teflon (Shapira & Zingales 2017). It was not the media that exposed the harms of Teflon, but rather a group of farmers living near DuPont's plant that sued after they suspected the plant's emissions were toxic, as their cattle died after drinking water from a creek close to a landfill. The public revelation of Teflon's harms occurred only after the discovery process and subsequent trials that the litigation kickstarted (Shapira & Zingales 2017).

#### *Non-market actors drive collective action*

The example of Teflon highlights the important role in collective action in both the public and private spheres (Hiatt, Grandy & Lee 2015) that non-market actors play in the functioning of

markets. The litigating farmers were members of the *public*. More often, it is organized *stakeholders* like civic and environmental groups that play the role of informing and organizing the public, and they may at times even litigate in the public interest and act as a check on the power of influential corporations. For example, organized environmental nonprofits use information disclosures on the environmental impact of firms to help customers make informed purchases on sustainable products (Delmas, Lyon & Jackson 2019).

In the aftermath of the major 1984 industrial disaster in Bhopal, India, in a plant owned by US chemical manufacturer Union Carbide, both the firm and the government shirked full responsibility for the tragedy, despite it being in public knowledge. In this case, it was organized local and international civic groups that sustained a long public campaign for compensation for the victims (Jose 2016). Such activism raises the costs of an environmental disaster for businesses. In the absence of such activism, such environmental disasters may become an unmitigated negative externality, where the firms do not have the incentive to take responsibility while political institutions—which should impose costs—fail. Still other non-market actors are academics (in public institutions), who can shape public conversation about firms and their role in markets. The influence of the Chicago School in antitrust law (in the promotion of the consumer welfare standard) is a salient example of the influence of academia on business and markets.

The absence of influential non-market actors can seriously hamper the effectiveness of the market-based system. In non-democratic countries, such as Russia, where non-market actors are weak, oligarchies with deep political ties can persist in the economy with immunity. In such non-democratic countries social media can create an alternate platform for non-market actors. Enikolopov, Petrova and Sonin (2018) found that social media (blogs) can discipline corruption in Russia, where blog posts that exposed corruption in Russian state-controlled companies negatively affected their market returns and led to higher management turnover and fewer minority shareholder conflicts. Additionally, non-local non-market actors can play a significant role in countries with weak local non-market actors. For example, Dyck, Volchkova, and Zingales (2008) found that coverage in the Anglo-American press could discipline the corporate governance of firms in Russia.

If the actions of firms and regulators can be scrutinized thoroughly and publicly by non-market actors, market actors (firms) that would otherwise be pursuing self-serving *pro-business* policies, such as withholding information (DuPont) or shirking responsibility for negative externalities (Union Carbide), can be pushed to pursue the other maximizing, market-forward or aligned policies in Table 2. This dynamic between market and non-market actors can sustain a dynamic market-based system.

### **Incentives of Non-Market Actors**

Non-market actors, even in the same issue space, are heterogenous and driven by a variety of interests and policy preferences (Crosson, Furnas & Lorenz 2019). As long as there exists a "thick" non-market environment (Henderson & Ramanna 2015) where heterogeneous pressure groups compete (Becker 1983), individual non-market actors, despite their biases, can in aggregate perform the functions of reducing information asymmetry, revealing externalities, and driving collective action. However, if the non-market environment thins down, the diversity and hence the effectiveness of such actors is reduced.



Such thinning of the media environment has been a topic of academic enquiry recently (Hamilton 2016; Rolnik et al. 2019). For example, Hamilton (2016) has described investigative journalists as "democracy's detectives," as they perform a fundamental role of uncovering new information, often against the wishes of powerful actors. Production of such investigative news is like "taking a risky bet" (Raj & Rolnik 2018), with high fixed costs of producing news, high hazards such as lawsuits, and uncertain revenue (Hamilton 2016; Rolnik et al. 2019). The economic or institutional environment can alter the incentives to take such risky bets. For example, the nature of libel laws (Barendt et al. 1997) influences the hazard costs of producing investigative journalism.<sup>10</sup> Similarly, the (in)ability to generate revenue through higher subscription rates or advertising adversely affects the ability to produce independent (Gentzkow, Glaeser & Goldin 2006; Petrova 2011) and investigative news (Angelucci & Cagé 2019).

### **Implications for the Pro-Market Policy Cycle Paradigm**

As non-market actors, in a non-captured non-market environment, push firms away from pro-business policies, they also inform our pro-market policy cycle paradigm (Figure 1). As we discussed in the previous section, firms are more likely to support pro-market policies along with pro-business policies (aligned policies in Table 2) in growth markets (the second stage of Figure 1) and pro-business (crony capitalist policies in Table 2) policies in less mature and highly mature markets (the first and third stages of Figure 1), forming an inverted U-shaped curve. However, the presence of non-market actors can push firms in such crony capitalist markets towards pro-market policies, as discussed in this section.

***Proposition 4:*** In markets at any level of maturity (exploratory, intermediate, or mature) where there is a thick density of non-market actors, firms will have a greater tendency to embrace pro-market policies as non-market actors will constrain firms' ability to maintain pro-business positions without public and consumer backlash.

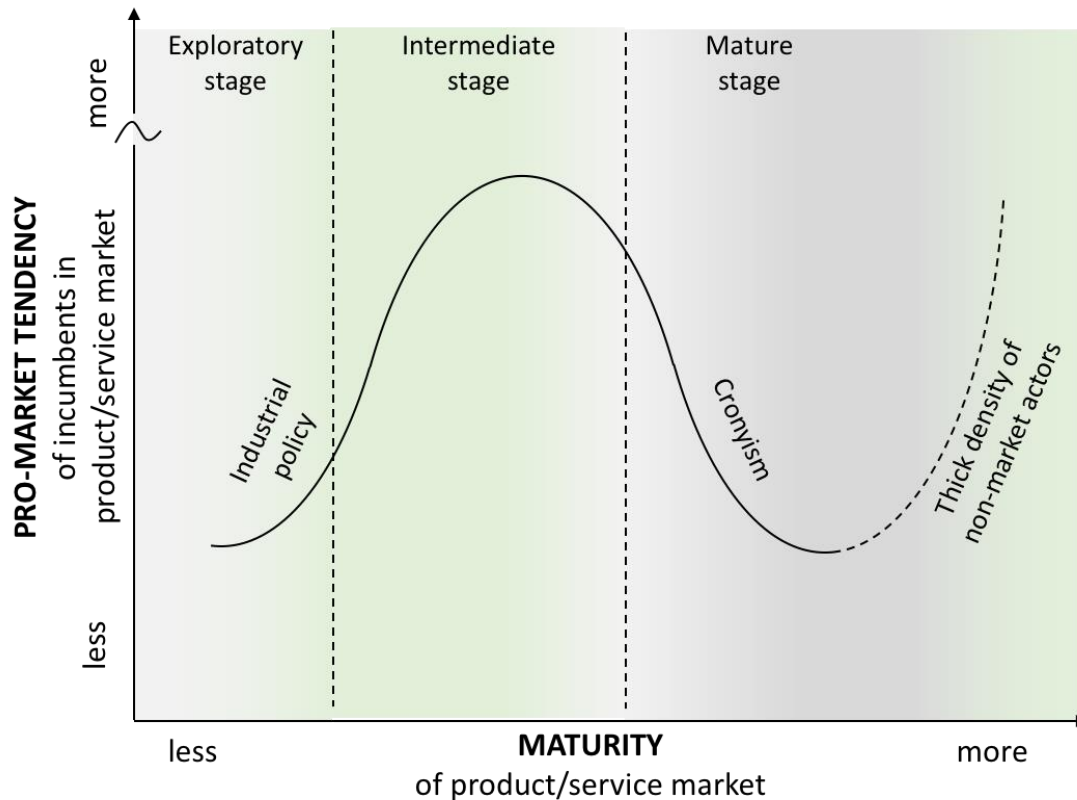
Figure 2 extends the pro-market policy cycle paradigm in Figure 1 developed in the third section of the paper, where the presence of non-market actors can push firms to pursue aligned pro-market policies. This will be true, and all the more relevant, in the highly mature stages of the market, where the absence of non-market actors would have otherwise produced a market of cronies. By extending the cycle, we also offer a theory that integrates four seemingly different strands of literature that relate to markets: the neoclassical market paradigm (Friedman 1970, Stigler 1971), the new-institutional perspective (Olson 1982, North 1991), the industry cycle literature (Klepper 1997, Agarwal & Barguinsky 2015), and research on the role of social movements and non-market actors (Baron 1995a, Davis et al. 2008, King & Pearce 2010). Of course, the market can escape or emerge out of a crony stage only if the non-market environment is effective in influencing firms. However, even in the case of non-democratic countries like Russia, we find that non-market actors continue to have influence, even though there is always a

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<sup>10</sup> The rise of muckraking investigative journalism in the first decade of the 20<sup>th</sup> century coincided with the rise of a thriving classifieds business and reduced costs of printing due to technological innovations, which increased the capacity of newspapers to pursue investigative stories (Raj & Rolnik 2018). With low barriers to entry in the media industry in this era, greater competition incentivized media companies to take risky bets in pursuing investigative stories, giving rise to the muckraking age, which declined in the 1910s with greater industry consolidation and reducing competition (Raj & Rolnik 2018).

potential for capture of the non-market space even in mature developed economies, e.g., through astro-turfing (Lyon & Maxwell 2004), media (Zingales 2016) and academic capture (McDonald 2017).

**Figure 2: Extended Pro-Market Policy Cycle**



### How Do Firms React to Non-Market Actors?

There are different types of responses firms can give to pressure from non-market actors. As thin political markets favor pro-business policies, if a firm is lobbying for anti-market public policies, it will be interested in preventing the public policy issue from becoming “widely salient” (Bonardi & Keim 2005). Hence, firms can attempt to *manage* non-market actors, such as through impression management (McDonnell & King 2013), which has been the classic recommendation (Baron 1995a; Bach & Allen 2010) in management on the topic of “tackling” the non-market environment. Managing non-market actors is akin to reducing the ability of non-market actors to shift the firm from its preferred pro-business policy. McDonnell, King and Soule (2015) study activist targeting of firms, and they develop a process model where the strategic response of firms evolves from being defense to taking “incidental” steps of empowering independent monitors and increasing corporate accountability.

A more insidious form of “tackling” the non-market environment is through *capture* of the non-market environment, such that non-market actors themselves endorse policies in line with the

pro-business interests of firms, hence inverting their role. The threat of such capture comes from firms that can build “astro-turf” grassroots organizations to pursue their interests, often shrouded in philanthropic donations (Kraemer, Whiteman & Banerjee 2013). Similarly, the capture of the media by firms through advertising or ownership (creating advertiser and ownership bias) is a topic of great importance in media studies, but the topic has been largely ignored in the management literature. One form of media capture is by banks. For example, Zingales (2016) suggests that Italian newspapers that are more indebted are more likely to agree with banks, whatever the interest of banks may be. Another form of capture comes in the form of academic capture that has lately begun to gain salience in intellectual discourse. For example, McDonald (2017) sheds light on the corporate influence over what is taught about firms, as he points out that firms granting access to *Harvard Business School Publishing* case writers can control the content of the cases written and discussed, skewing things more positively.

In developing economies, the private sector is small, competition is weak, and pro-market reforms that expand competition and the size of the private sector can face opposition from the small base of private- and public-sector incumbents who enjoy outsized influence (Rajan & Zingales 2003). In developing economies, the possibility of non-market actors pursuing anti-market and protectionist policies looms larger, as the small base of business-interest groups can wield large influence over them. For example, Gentzkow, Glaeser and Goldin (2006) and Petrova (2011) show that independence of newspapers increased in late-19<sup>th</sup>-century United States with diversification of the economy and an increase in advertising revenues.

As it is desirable in the long term for firms to position themselves in a manner such that they pursue aligned policies (Table 2) that are pro-business for them, while also being pro-market (e.g., the case of Hewlett Packard), to find this unique positioning, firms can instead *listen* to non-market actors to find policies that help the firm (pro-business) in a pro-market (i.e., competitive, externality reducing) environment. Organizations like Hewlett-Packard, Whole Foods or Unilever, are positioning themselves as environmentally conscious firms by listening to non-market actors, such that pro-market policies—which minimize the negative externalities of carbon emissions or pollution—create a favorable advantage for them in the long run.

#### *Extending to the Auto Industry Case*

Above we discussed the cyclical nature of the pro-market orientation of automobile manufacturers as the industry matured: starting with concerted anti-market efforts to undermine competing transportation infrastructure in the exploratory stage (1930s), then moving to support for pro-market policies of enforcing safety standards in the intermediate development stage (1960s) and back to support for anti-market and protectionist policy of government bailouts in the mature stage (1980s), when facing tough competition. In this mature market, emission standards have become the latest market-level issue that has gained the attention of governments and market and non-market actors. As emission standards regulate the level of pollution that automobiles emit, they have lately attracted significant attention from non-market actors, especially environmental groups such as the Environmental Defense Fund and Greenpeace.

In 2019 automobile manufacturers displayed an aligned (pro-market and pro-business) strategy where a group of major firms supported policies that reduce automobile emission externalities. How did this come about? The US state of California has been granted a federal

waiver to set its own automobile emissions standards, which are more stringent than those of the rest of the United States. Despite a push from the federal government to enforce a nationally uniform emission standard that is lower than California's emission standards, four major automobile manufacturers (BMW, Ford, Honda and Volkswagen) in an “extraordinary move” (Davenport and Tabuchi 2019b) agreed to follow California's standards nationally, citing concerns over “regulatory uncertainty”. A few months later, another faction of automobile manufacturers (including General Motors, Fiat Chrysler, Nissan and Toyota) publicly supported the federal government, breaking away from the faction that supported the California led standards, creating a split in the industry (Tabuchi 2019).

Noteworthy, initially the automobile manufacturers had supported the federal government in loosening the strict emission standards federally (Davenport and Tabuchi 2019a). However, this pro-business stance turned into a “crisis” (Davenport and Tabuchi 2019a) following pressure from environmental groups and media coverage (Bliss 2019), and alarm caused by influential lobbying from the refining industry and climate change–denying groups that advocated for drastically reducing standards. In response, a major faction of automobile manufacturers weakened their stance and agreed to follow a national standard set by California and 13 other US states that pledged to follow it, while another faction decided to support the opposing stance of the federal government (Tabuchi 2019). The firms that are supporting higher standards led by California include Honda – whose vehicles have the highest average fuel economy among major manufacturers – and Ford and Volkswagen that are betting on sustainable electric vehicles technology in their future product pipeline (Geman 2019) i.e. firms that have aligned their policies with the pro-market concerns of reducing the negative externality of carbon emissions.

## DISCUSSION/CONCLUSION

### Managerial Implications

#### *Implications for Strategic Management*

Over the last few years, there has been a rising debate over whether firms are responsible to stakeholders beyond the shareholders. This is part of a broader debate about the role of business in society, one in which CEOs have been actively participating (Chatterji & Toffel 2016). In 2019, 181 chief executive officers associated with the Business Roundtable<sup>11</sup> stated that they resolved to move away from “shareholder primacy” and move to “include commitment to all stakeholders.” However, as critics of the statement pointed out, such a normative commitment lacked credibility, with one reason being that CEOs themselves are firm employees that represent shareholders. Hence, only if shareholder interests align with the interests of the broader stakeholders can such a commitment to stakeholders be considered credible (Hart & Zingales 2017; Morgan & Tumlinson 2019).

The above issue presents a broader concern. There exist many normative formulations (Freeman et al. 2010) of how business ought to be done to help all stakeholders of society, yet as Vogel (2007) points out “the market for virtue is limited.” That means the challenge for managers

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<sup>11</sup> A Washington, DC–based non-profit association, whose members are CEOs of major US companies.

becomes how to align profits with social value. Hence, when thinking about business strategy, managers should be seeking to find policies that are good for the market as well as for business. In other words, it is important for managers to adopt proactive positions to embrace pro-market positions (Fremeth & Richter 2011). By developing a better understanding and awareness of whether a business policy creates market frictions and externalities, firms can actively identify strategies that are pro-market while also being pro-business. This can offer a unique strategic position to the firms that they can leverage in the long run.

As firms can shape the markets they operate in (Pisano & Teece 2007), they can also shape them in a manner aligned (Table 2) with the interests of both their firm and their market (e.g., the examples of HP and Tesla in the "Aligned Policy" cell of Table 2). Bagley (2008) calls such ability to create value out of regulatory (and by extension non-market) requirements to be "legal astuteness," where, for example, firms go beyond fulfilling minimum environmental requirements and create value by pursuing sustainable business practices. Consider the case of Apple, which has positioned itself as a pro-privacy and pro-sustainability firm in the market. Such a positioning is a carefully crafted long-term strategy, which firstly identifies the pro-market strategy: a strategy that does not create large negative externalities for people's privacy and the environment. Secondly, the company has uniquely positioned itself (in contrast with competing firms) to benefit from such a pro-market positioning. Hence, by placing itself in the pro-market and pro-business cell of our conceptual framework ("Aligned Policies" cell in Table 2), the firm is more secure against being targeted by non-market actors as well as regulators. At the same time, the firm has such a positioning that the incentives of its shareholders and its broader stakeholders are aligned, and hence it can credibly commit to its pro-privacy, pro-sustainability position. This does not mean that Apple management got its aligned policy right the first time. However, when a non-market actor, the *New York Times*, came after it for issues at its supplier Foxconn, Apple aimed to fix the problems where it could, thus listening to the non-market actors, not "managing" them.

In our framework, we do not undermine the notion that a firm's primary task is to maximize shareholder value. Hart and Zingales (2017) argue that shareholder "value" does not imply shareholder "wealth" and show that shareholder value maximization, where shareholders have prosocial utility (along with monetary interest) is congruent with the formulations of Friedman (1970). However, their formulation does not account for the fact that shareholder values are not exogenous and change over time. In addition, both the level of maturity of the product/service market and actions by non-market actors—as we argue—can influence these values of shareholders and align or misalign them with those of the broader stakeholders of the firm.

### *Implications for Entrepreneurship*

Our framework also has implications for entrepreneurship policy. Generally, it is prescribed that it is the role of policymakers to develop level-playing-field pro-market policies for all firms (Zingales 2009). However, in the case of less mature product and service markets (the Industrial Policy phase of Figure 1), policymakers may enact temporary pro-business policies until the market matures (Rodrik and Subramanian 2005). Such *temporary* support may also be needed for entrepreneurs venturing into new industries in order to accumulate the necessary resources and capabilities (Lazzarini 2015) until these industries mature (e.g. in emerging economies (Pritchett, Sen and Werker 2017)). However, as highlighted by Tullock (1975), such a temporary policy that

favors the initial incumbents of a market is prone to traps, and more research will be needed on the conditions that safeguard against such traps.

Moreover, our framework also highlights that promotion of entrepreneurship, which increases competition in markets, is not a policy that market actors will embrace uniformly and at all levels of market maturity. Hence, our paper can help scholars understand the political economy of entrepreneurship. If incumbent market actors are powerful, and non-market actors are scarce, for example, resulting in thin political competition (Paik, Kang and Seamans 2019), the entry of new and competing firm may be hampered, limiting the levels of competition and entrepreneurship.

### *Implications for Management Education*

The framework the paper offers also highlights a need to reassess management education. Firstly, teaching students about market frictions (Table 1) and how firms can influence these frictions can create awareness that firms are actors within a broader and imperfect market system. Secondly, our framework highlights the importance of recognizing the different levels of maturity of product/service markets, as we argue that the pro-market tendencies of businesses vary depending on the market's maturity. Such an appreciation of different types of markets adds more institutional context to management education, as the dynamics of competition and the strategic response differ in these contexts. Thirdly, we call for a greater focus on non-market actors in management education, and a shift away from focusing on “tackling” or “managing” them, to a framework that credibly and non-normatively includes listening and working with them. We argue that there is a need to conceptualize markets as an interlinked system that includes firms, other market actors (suppliers, buyers and consumers), government, and non-market actors.

### **Implications for Capitalism**

The paper provides three important implications for capitalism. Firstly, through clearer definitions of *pro-business* and *pro-market*, it helps clarify the debate on how self-interested managers can make decisions in the interest of the broader society. We argue that under a broad set of conditions, firms do indeed pursue policies that are not in the interest of sustaining markets and the capitalist system. However, under a limited set of conditions, (i) when a market is in the growth stage or (ii) when there is a thick presence of non-market actors, firms may be inclined to pursue pro-business policies that are also aligned with pro-market interests, i.e., by focusing on innovation or by positioning themselves in a manner to positively benefit from pro-market positions of regulators and non-market actors.

Secondly, the pro-market policy cycle paradigm highlights that the capitalist system and behavior of actors in the system may be contrastingly different depending on the level of maturity of the product/service market. This has implications for the entry strategy of firms, too, as the same firm may show different levels of pro-market orientation in different types of markets.

While we focus on the maturity at the level of product/service markets, this framework can be abstracted to the level of an economy. In some economies more product/service markets are mature on average; in such mature economies the pro-market orientation of firms will be different, and so will the response of policymakers. Hence, as our cycle shows, a less pro-market and a more

industrial policy-oriented approach may be in the interest of the broader development of markets, as has also been shown by Rodrik and Subramanian (2005) in 1980s India.

Thirdly, our paper highlights an important implication for advanced capitalist democracies. Many of these economies, especially the United States, have been portrayed as “crony capitalist.” As our framework shows, this may be an outcome of the maturing of markets where competition was previously intense, which incentivizes incumbents to pursue influence rents (Ahuja and Yayavaram 2011) such as through lobbying (Munger & Villarreal-Diaz 2019) at the cost of other forms of efficiency or Schumpeterian rents (Utterback & Abernathy 1975; Aghion et al. 2005; Zingales 2017).

Principled managers may reject seeking and obtaining special privileges as a means to increase profits, but even morally sound CEOs and managers face clear economic incentives and pressures to increase profits. These incentives make the pursuit of special privilege attractive, particularly in mature stages of markets where the returns of innovation tend to dissipate, as we discuss. In the absence of active non-market actors and their potential corrective influence, or policy makers who will support pro-market policies firms can get behind, firms and managers may not commit credibly to aligned pro-market/pro-business policies.

Hence, while Business Roundtables can keep the conversation brewing, our framework suggests the credible way out of this “crony” scenario is by appreciating the centrality of non-market actors in influencing this conversation. In the current neoclassical conceptualization of capitalism, there is little role of such actors. As our paper highlights, these actors have been ubiquitous (Baron 1995a; Davis et al. 2008; King and Pearce 2010), but in neither the management nor the economics literature have they received their due share. Going forward as advanced economies grapple with the role of business in society, the role of such non-market actors in shaping markets and their function may be crucial in determining the future of capitalism (Phase 4 of Figure 3).

### **Implications for Research**

Our framework also highlights the need to advance research in the area of “integrated strategy,” an area that currently has few studies (Baron 1995b; de Figueiredo 2009; Holburn & Vanden Bergh 2014; Dorobantu, Kaul & Zelner 2017; Oberholzer-Gee & Yao 2018) but that breaks down the silos of market and non-market strategy. Given the emphasis we put on the distinction between pro-business and pro-market strategies, market maturity, and non-market actors, we believe each of these issues in themselves provides fertile avenues for future research. One of the most immediate areas researchers can focus on is understanding the ways in which firms can pursue policies that are both pro-business and pro-market, i.e., in the “Aligned Policies” cell of our Table 2, such that their strategic positioning is sustainable in the long term and so is the health of the overall market system of which they are a part.

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