
Non-Market Strategies and Asset Specific Investments

Conference on Applied Infrastructure Research INFRADAY 2008

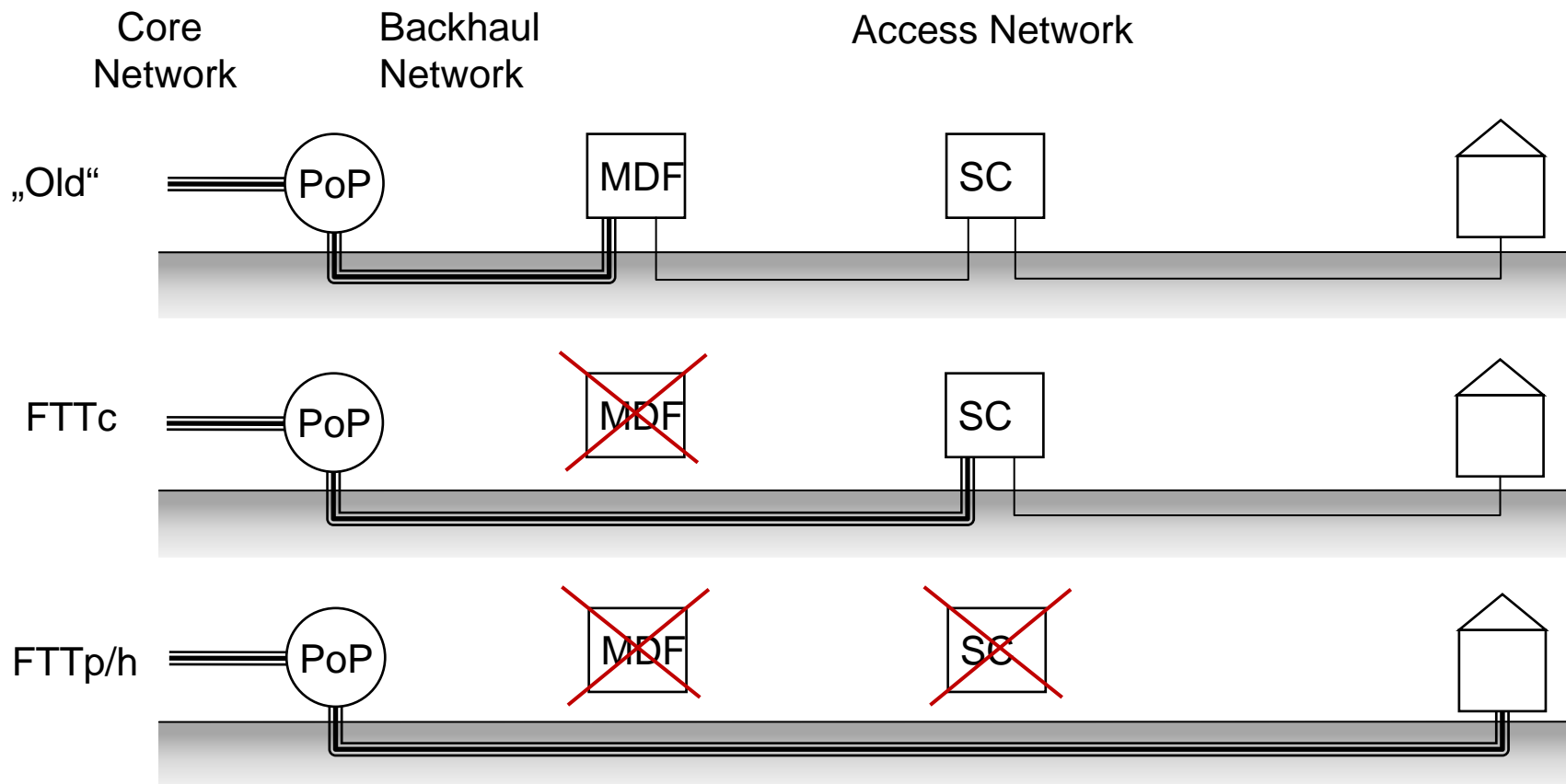
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Agenda

- 1. Motivation and Problem Statement**
- 2. Political Markets and Non Market Strategies**
- 3. Case Study of the German VDSL Regulation**
- 4. Conclusion**

Investments in Telecommunication Access Networks

Deployment of “Next Generation Access Networks” (NGAN) in the local loop
-> Replacement of copper access network loop with fiber optics



Characteristics of Investment

Large Scale

- Change lines to every street cabinet
(e.g. in NL: 15T k m fiber, 24.000 - 28.000 street cabinets)
- Groundwork in urban and rural areas (depends on availability of ducts)
- Netherlands: 0.9bn €(incl. switch to All-IP)
- Germany: ~3 bn €to deploy FTTC to 2.9 million households in 10 cities

Asset Specific

- Up to 2/3 of the deployment costs are ground work
- Low value of second best use

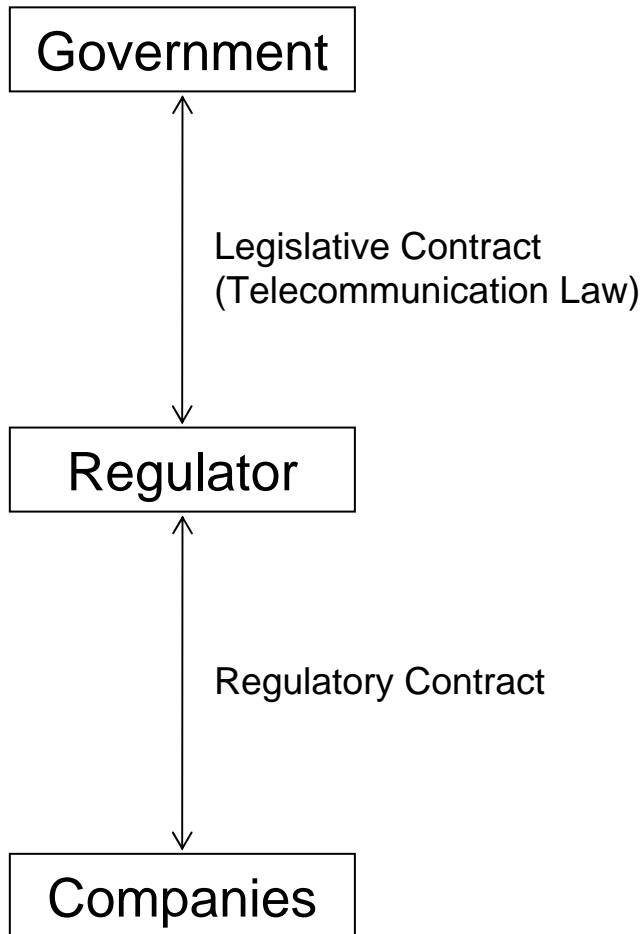
-> In the prospect of regulation there is a threat of capture of quasi-rents by regulator / Hold-up problem

Question

- I. How do companies attempt to influence their institutional environment under the prospect of regulation?**

- II. Do these attempts vary with the degree of asset specificity of investments?**

Framework for Analysis



Assumptions:

-Information: Government and regulators are imperfectly or asymmetrically informed
-> incomplete contracts

-Behavior: Government and regulators are not benevolent but act in self interest and under bounded rationality

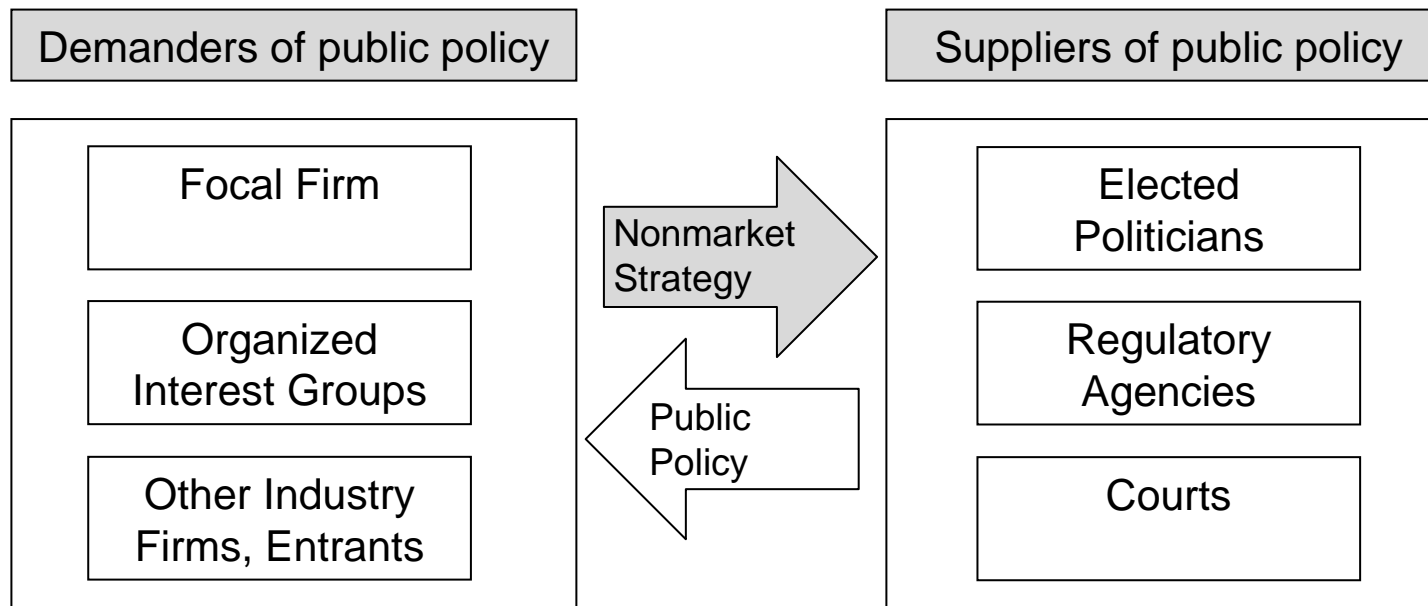
-Asset specific investment generate quasi-rents

Incomplete contracts and self interested behavior give leeway to firms influence on public policy

Theory of Political Markets

Assumptions:

- Regulation is shaped by the competition of political forces (Stigler 1971)
- Political markets are analogous to economic markets
- Firms trade non-market strategies e.g. information, in exchange for public policy



Holburn et al (2006), Non Market Strategy performance

Components and Key Mechanism of Non-Market Strategies

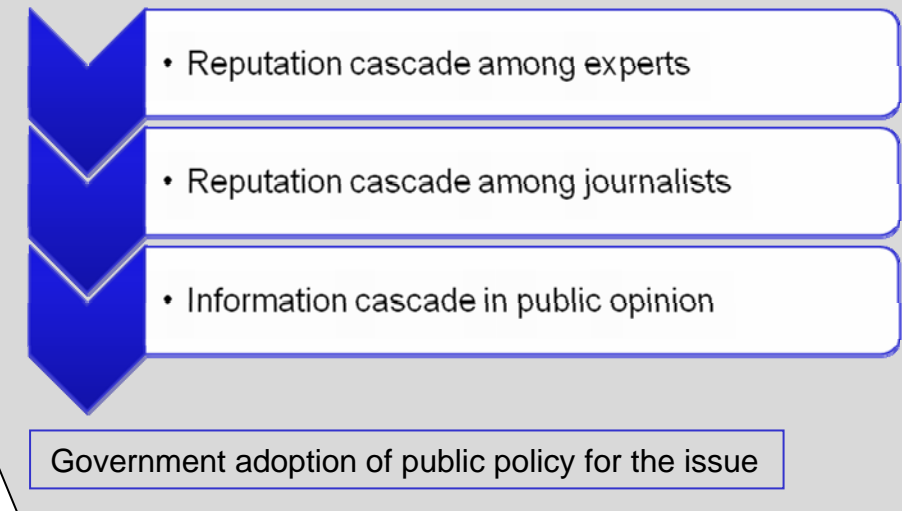
Taxonomy of Non-Market Strategies

Strategy	Tactics
Information	<ul style="list-style-type: none"> - Lobbying - Research - Experts - Publications
Financial incentive	<ul style="list-style-type: none"> - Contributions / donations - Personal services (Revolving door, etc.)
Constituency-building	<ul style="list-style-type: none"> - Public relations - Grassroot mobilization

Timing of Non-Market Strategies

Widely salient issues:

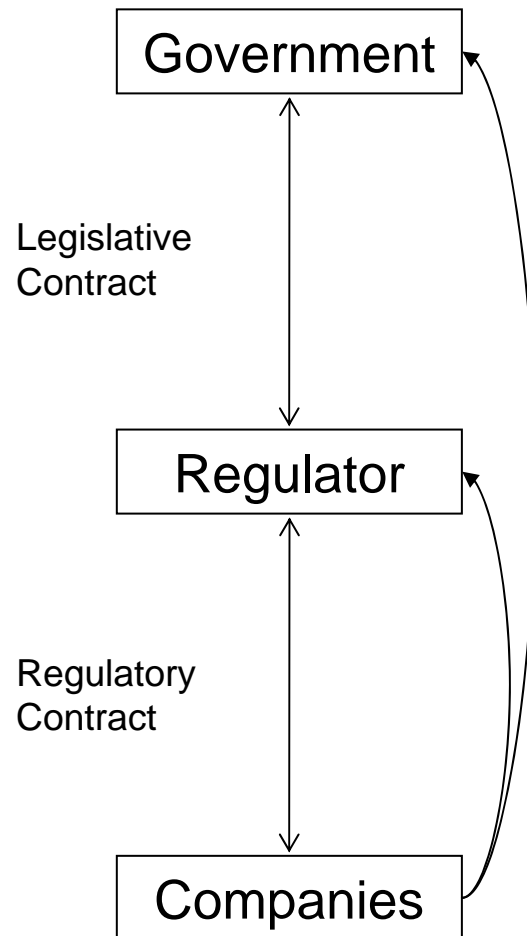
Bonardi et al (2005), "Widely Salient ISSUES"



The earlier the better for widely salient issues

Hillmann and Hitt (2006), Corporate Political Strategy

Attractiveness of Political Market



Attractiveness of political markets

- *Demand Side*: Markets are attractive with concentrated benefits and diffuse costs
- *Supply Side*:
 - Rivalry between representatives makes market more attractive
 - Rivalry between bureaucrats reinforces the status quo

Empirical Evidence of Firms Influence on Public Policy

Bonardi et al. (2004): Nonmarket Strategy Performance: Evidence from the US Electric Utilities, *Academy of Management Journal*. Dec 2006. Vol. 49, Iss. 6; p. 1209

- **Goal:** Measurement of the performance of non market strategies
- **Data:** Rate of Return review decisions in US electricity industry from 1980 to 1992
- **Result:** Positive correlation of the decision to initiate rate review and performance

Edwards and Wavermann (2006): The Effects of Public Ownership and Regulatory Independence on Regulatory Outcomes, *Journal of Regulatory Economics*, Vol. 29, Iss. 1, p. 23

- **Goal:** Link public ownership with regulatory outcome for access rates
- **Data:** Panel data for access rates for 15 EU countries (1997-2003)
- **Result:** Public ownership is associated with favorable regulatory outcomes for the incumbent

Figueiredo and Edwards (2005): Does Private Money Buy Public Policy? Campaign Contributions and Regulatory Outcomes in Telecommunication, *Journal of Economics and Management Strategy*, Vol. 16, Iss. 3, p. 547

- **Goal:** Link variations in access rates and the level of campaign contributions
- **Data:** Panel data for US electoral cycle 97/98, 99/00, 01/02
- **Result:** Private money can influence public policy outcomes

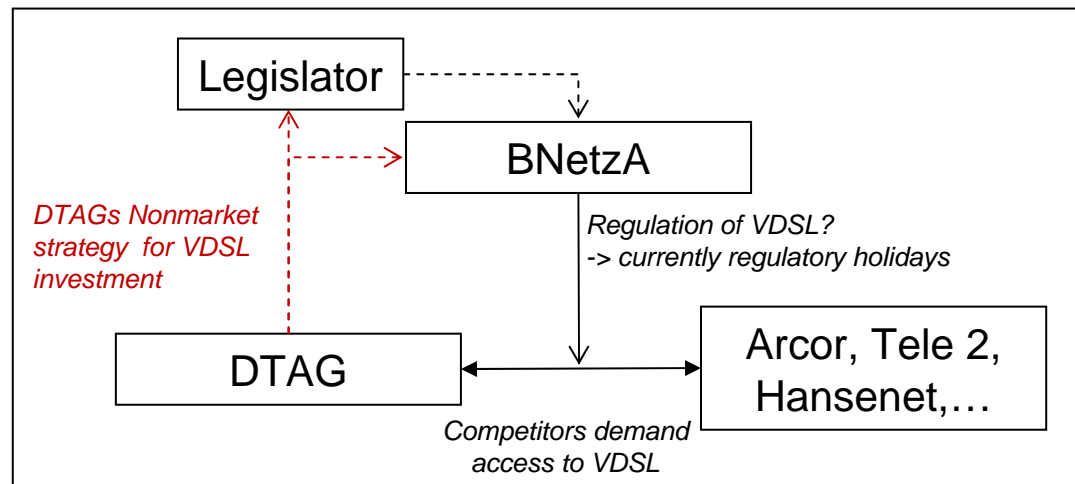
Regulatory Capture

- **Regulatory capture theory views political influence by firms as rent seeking**
- **We acknowledge this view but argue that there is an additional efficiency rational to these strategies.**
- **We picture a setting in which the possibility for innovation, requiring asset-specific investment, requires a change in the regulatory contract.**
- **A properly designed strategy will attempt to convince legislators as well as the regulator agency that a change in regulatory contract is necessary to induce investments, whereas a failure entails the threat of sub-optimal investments.**
- **However, the regulator/legislator, being imperfectly and asymmetrically informed, faces the challenge of determining whether the firm pursues primarily strategic or efficiency objectives.**

Case Study Germany Overview

German case in a nutshell:

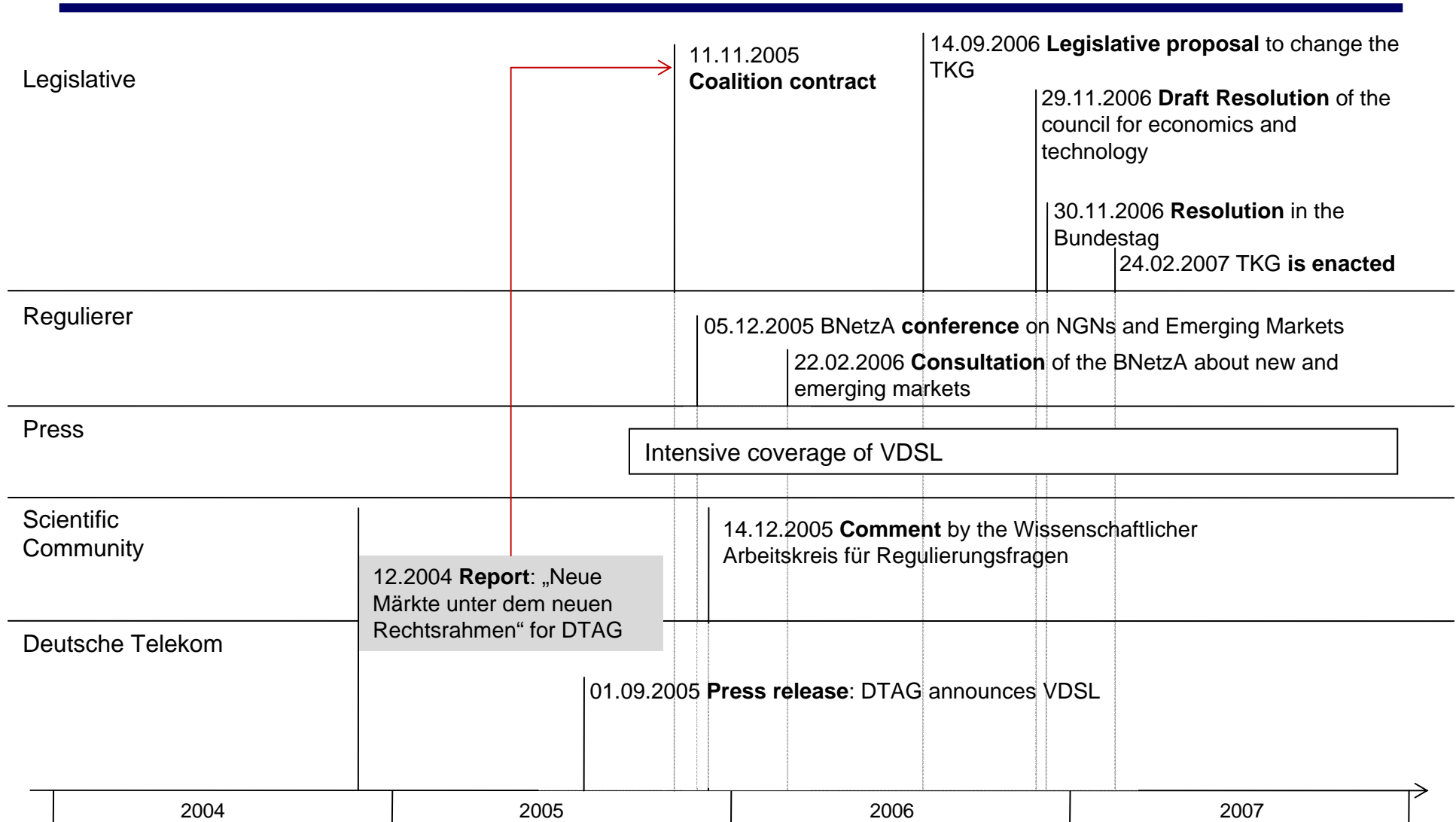
- DTAG makes ~3 bn € investment in FTTc, investment decision contingent on regulation
- German legislator allows regulatory holiday for „new and emerging markets“ (success)
- EU challenges this decision before the European Court of Justice



DTAG Non-Market strategy:

- Information strategy (early expert report from reputable researchers)
 - Targeting the legislative contract (coalition agreement after election)
 - Before the issue gained salience (which limits officials leeway)

VDSL Information Strategy / Information Cascade



Case Summary

Attractiveness of the political market for VDSL regulation:

- **Demand Side**
 - Concentrated benefits for DTAG
 - Diffuse costs for customers
- **Supply Side**
 - High political rivalry (grand coalition between CDU and SPD)
 - Independent regulator

Decision Parameter	Expected Behavior	Case in Germany
Strategy		
-Information	+	+ (Report)
-Financial	0 (limited applicability)	0 (no observations)
-Constituency	+	+ (lobby groups, press)
Timing	Early (widely salient)	Early
Target institution	Legislator (most attractive)	Legislator

Conclusion

- 1. Firms can attempt influence their institutional environment by the use of non-market strategies**
- 2. Besides rent-seeking behavior, non-market strategies can be an instrument to reach a mutually favorable outcome**
- 3. The success of a Non-Market Strategy depends on the strategy mix, the attractiveness of the political market, the timing, and the targeted institutions.**
- 4. Question of strategy variation with degree of asset specific investment is subject to further research. Empirical assessment proofed to be difficult so new approaches are needed.**