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Strategizing in an Unpredictable Climate: Exploring Corporate Strategies to Cope with Regulatory Uncertainty

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Government regulation of business activities is increasing rapidly, exposing firms to considerable uncertainty and requiring managers to decide on appropriate strategic postures. To help managers make informed decisions, this study compiles a comprehensive overview of strategies to cope with regulatory uncertainty and illustrates their interdependencies and how they can be combined into overall coping postures, as well as offering management guidelines on deciding which to adopt. A literature review identifies a considerable variety of coping strategies, and we apply unique data from a worldwide cross-industry survey to categorize each into one of three types – offensive, defensive or passive. We find that firms aiming to cope with the uncertainty associated with post-Kyoto regulation typically adopt one of four strategic postures, each characterized by a specific combination of these types: 'daredevils' rely solely on offensive strategies; 'coordinators' combine them with defensive ones, 'hedgers' pursue strategies from all three categories while 'gamblers' choose not to specifically cope with uncertainty at all. We exemplify the strategies characteristic of each posture, and illustrate their interdependencies by means of case studies in the European airline industry. We identify two main factors managers should consider particularly when deciding on their firm's strategic posture: the level of regulatory uncertainty they perceive and the firm's exposure to future regulations, and find that the higher the level of uncertainty, the broader the range of strategies applied, and the more future regulation seems likely to affect a firm, the more actively it seeks to cope with the associated uncertainty.

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Introduction

In late 2008, the subprime mortgage crisis in the United States escalated into a global economic shock that led to the collapse of major financial institutions around the world. Many economists and policymakers have ascribed these events to regulatory failures, calling for the restructuring of financial firms' business models and stricter control of international financial markets. In response, at a quickly summoned meeting, the world's largest economies adopted an agreement on stricter regulation of the financial sector. However, this raised more questions than it actually answered - in particular, its vagueness left financial firms with high levels of uncertainty regarding the design of any new regulations, how they might be translated into national legislation, and what might be the resulting impact on their strategies, business portfolios and organizational structures.[1]

Almost 20 years earlier, another global crisis requiring a concerted international response had become evident. In 1990, the Intergovernmental Panel on Climate Change had linked global warming to anthropogenic greenhouse gas (GHG) emissions, triggering several rounds of international negotiations that eventually cumulated in the adoption of the Kyoto Protocol in 1997. Although this regulation set clear GHG reduction targets for most industrialized countries, policymakers left many regulatory issues open, explicitly referring their resolution to subsequent negotiations. Obviously, this approach created high regulatory uncertainty for firms, especially with respect to the implementation of the Protocol in their countries and thus its impact on their business.

These examples have two fundamental aspects in common. First, policymakers' decisions to establish new regulation that aimed at intervening into firms' traditional business operations posed a considerable risk for these firms. Second, it exposed them to high regulatory uncertainty. In more general terms, increasing international regulation for trade, social, and natural environmental purposes exposes firms to continuous uncertainty, so that, more than ever, coping with this uncertainty constituted a fundamental challenge for them.[2]

One way for firms to manage political risks and reduce the transaction costs associated with an uncertain policy environment is to participate in the policy process themselves, with the aim of influencing policymakers. Such political activity is typically an integral part of firms' strategies, and abundant research has addressed its antecedents, types and outcomes.[3] While this research has largely focused to date on domestic policy, scholars have increasingly begun to address firms' political activities in an international context.[4] Results suggest that coping with regulatory uncertainty by exerting influence on policymakers is considerably more difficult for foreign firms, which typically lack the established relationships and the legitimacy of local competitors and commonly complement their political activities with other coping strategies, such as imitative behavior or a sequential market entry.[5]

Combining individual strategies into an appropriate overall strategic posture is a complex challenge for managers. There is abundant research that reflects the critical effect of uncertainty on corporate activities by addressing individual strategies. Typically, however, such research studies only consider how single strategies are used to address a number of uncertainties, often limiting the context to a single industry (or even a single region).[6] In contrast, research that examines these problems from a converse stance — i.e., by investigating the full range of possible strategies available to deal with one particular type of uncertainty across several industries and regions - remains surprisingly limited.[7] So managers have been given little broad guidance as to how to cope with regulatory uncertainty in general. But, as we note above, the increasing incidence of global, cross-sector regulation makes it imperative that managers be in a position to make informed decisions about which strategic posture they should adopt to address this uncertainty effectively.

Increasing global, cross-sector regulation makes it imperative managers can make informed decisions about strategic postures to address uncertainty effectively.