20106
Management Capstone

Lecture - Week 2

Dr Rebecca Dong UTS Business School

Learning Objectives

① Understand different theories in management:

- Resource Based View
- Social Network Theory
- Agency Theory (The principle-Agent Problem)

② Able to apply management theories into practice

③ Able to use appropriate theories in scholarly research

Resource Based View

Resource Based View

The resource-based view (RBV) is a managerial framework used to determine the strategic resources a firm can exploit to achieve sustainable competitive advantage.

Barney's 1991 article "**Firm Resources and Sustained Competitive Advantage**" is widely cited as a pivotal work in the emergence of the resource-based view.

RBV proposes that firms are heterogeneous because they possess **heterogeneous resources**, meaning firms can have different strategies because they have different resource mixes.

The RBV focuses managerial attention on the firm's internal resources in an effort to identify those assets, capabilities and competencies with the potential to deliver superior competitive advantages.

Resource-Based View: an overview at Science Direct

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Resource-Based View

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Diversification and Economies of Scope

R.A. Lowe, D.J. Teece, in International Encyclopedia of the Social & Behavioral Sciences, 2001

2.1 The Firm as a Set of Resources

The resource-based view seeks to understand why firms grow and diversify. The theory grew largely out of Penrose's (1959) study, in which she cites unused managerial resources as the primary driver of growth. Penrose recognized that internal managerial resources are both drivers and limits to the expansion any one firm can undertake. This stream of literature was expanded in the 1970s and early 1980s on the heels of significant diversification and firm expansion (Rubin 1973, Teece 1980, 1982).

The resource-based view advances the importance of firm-specific resources, that is, those resources that maintain value *in the context* of the given firm's markets and other resources that are difficult to replicate by other firms (Wernerfelt 1984). Such resources include managerial ability, customer relationships, brand reputation, and tacit knowledge regarding specific manufacturing process.

Resources are not the same as competencies or capabilities. Rather, a firm's access to resources and ability to mobilize and combine

Modeling Software Applications

Bran Selić, Sébastien Gérard, in Modeling and Analysis of Real-Time and Embedded Systems with UML and MARTE, 2014

5.4.2 Modeling synchronization mechanisms

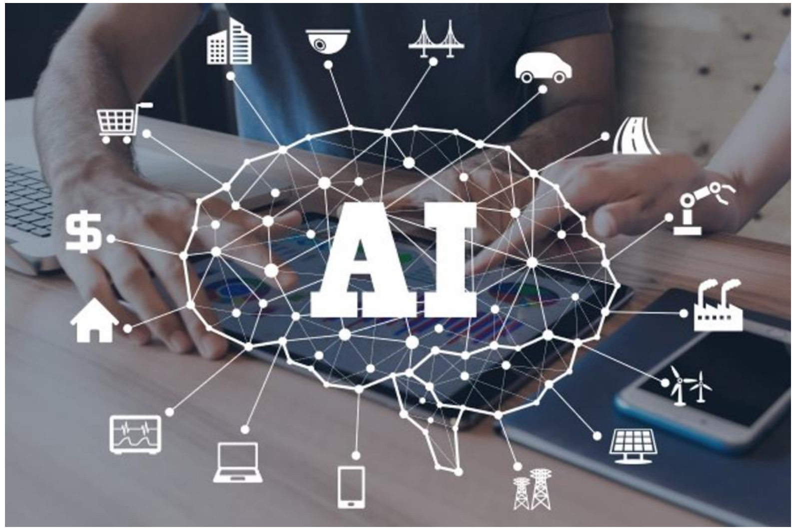
To deal with concurrency conflicts to shared resources, MARTE provides two possibilities, targeting different levels of abstraction:

- A detailed resource-based view, for cases where the specifics of the mutual exclusion mechanisms need to be spelled out, or
- A more abstract high-level representation where the mechanisms used to achieve mutual exclusion are implicit

The detailed model is likely to be more useful for purposes such as analysis and code generation, while the higher level view is better suited for more abstract architecture-level models.

5.4.2.1 A resource-based model of mutual exclusion

In this case, the devices (i.e., resources) used to achieve mutual exclusion are rendered explicitly. To this end, the general **Resource** stereotype is refined in several steps to capture some general characteristics of mutual exclusion mechanisms, culminating with



Resource Based View

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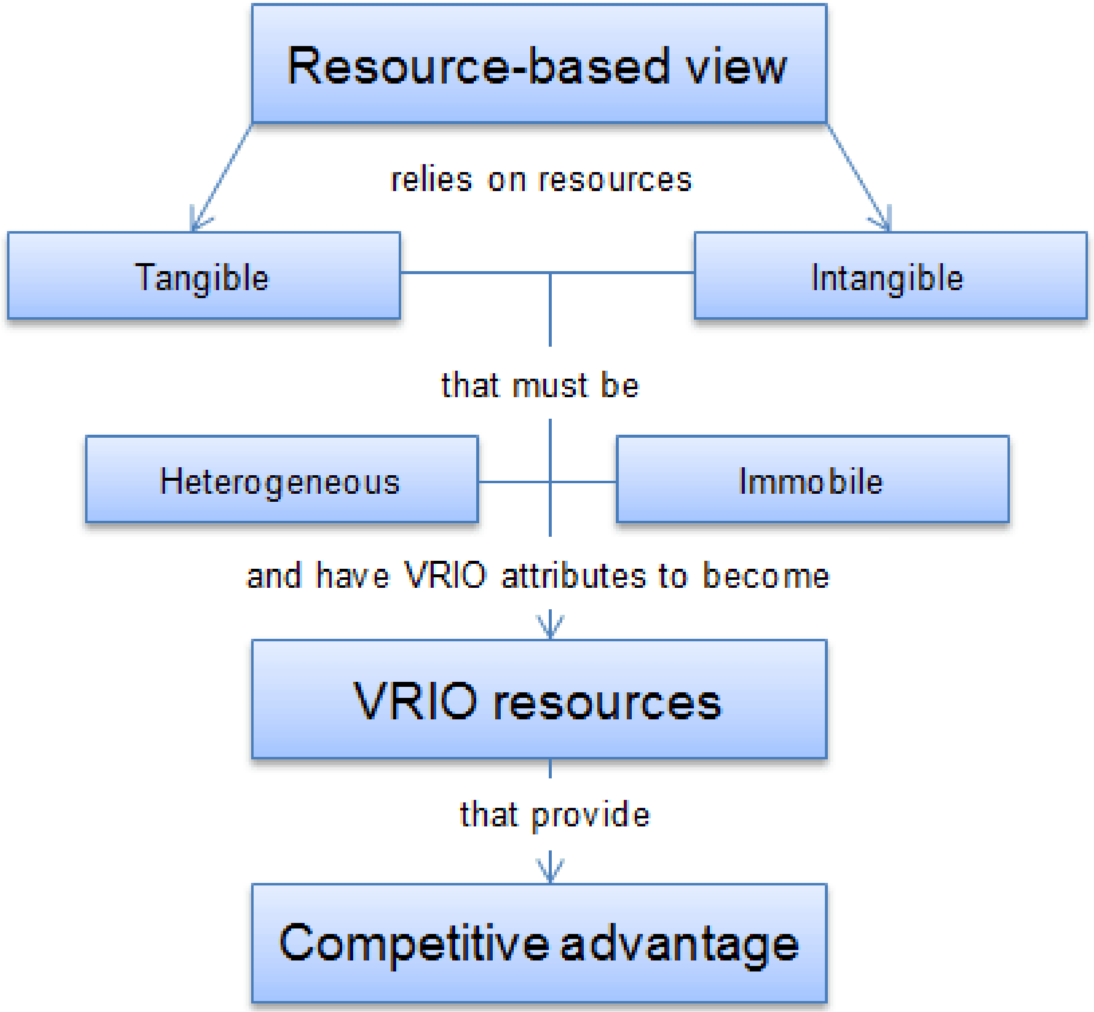
Resource Based View of the Firm

- Dominant theoretical perspective
- Resources, capabilities, competencies may be more important than industry effects
- Assumptions
  - Resource heterogeneity
  - Resource immobility
  - Firms are bundles of productive resources
    - Financial capital
    - Physical capital
    - Human capital
    - Organizational capital

Resource Based View



Understanding Resources and Capabilities

- **Tangible**
  - Resources and capabilities that are observable and easily quantified
  - Broadly organized in three categories:
    - Financial
    - Physical
    - Technological

Intangible

Resources and capabilities not easily observed or difficult (or impossible) to quantify

Examples include:

Human

Innovation

Reputation

Firm-level analysis: the VRIO framework

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- What is **VRIO** framework?

COMPANIES COMPETITIVE ADVANTAGE-VRIO FRAMEWORK

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V	**Value:** Do capabilities exist that are valued by customers and enable the organisation to respond to environmental opportunities or threats?
R	**Rarity:** Do capabilities exist that no (or few) competitors possess?
I	**Inimitability:** Are capabilities difficult and costly for competitors to obtain and imitate?
O	**Organisational support:** Is the organisation appropriately organised to exploit the capabilities?

The VRIO Framework: Value and Rarity

Four fundamental questions of VRIO

Value: do the resources and capabilities add value?

Necessary for a competitive advantage

Rarity: how rare are the valuable resources and capabilities?

Valuable, but ***common*** parity, not advantage

Valuable ***and*** rare can lead to temporary advantage

If everyone has it, you can't make money from it

Value

Strategic capabilities are of value when they:

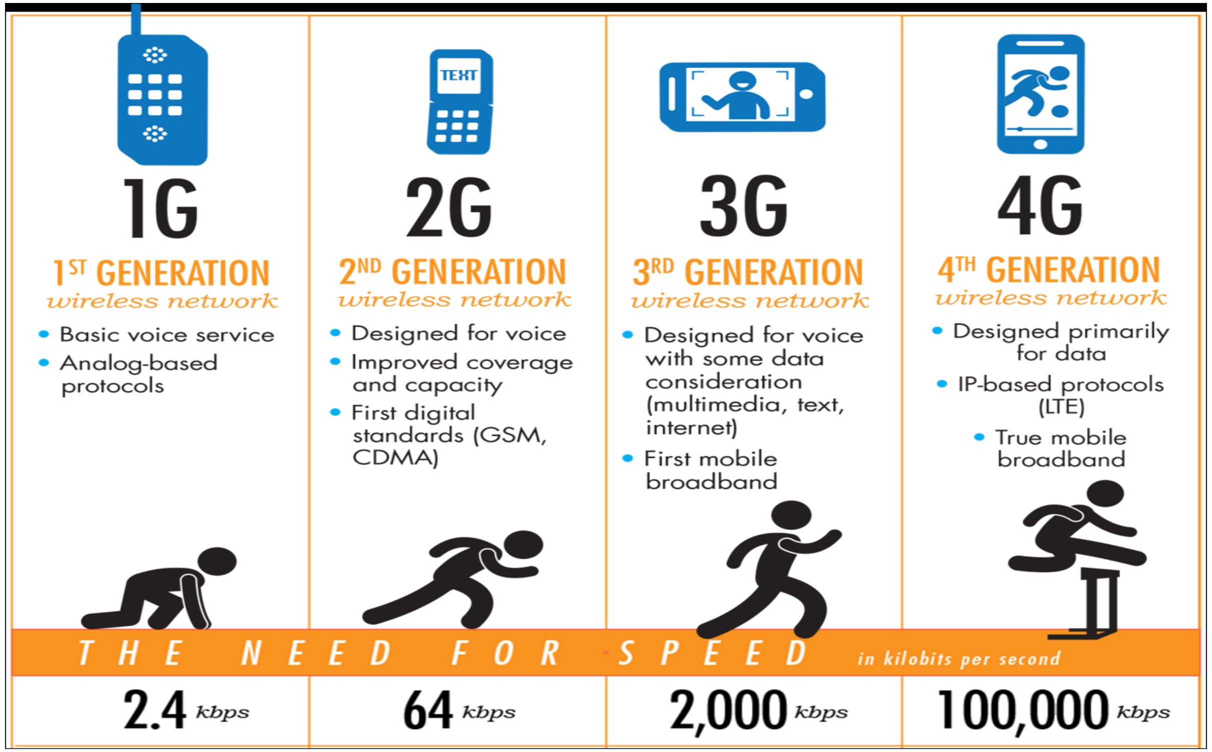
take advantage of **opportunities** and neutralise threats that provide value to customers at a cost that still allows an organisation to make an acceptable **return**.

ZARA

STARBUCKS COFFEE

Rarity

- ***Rare capabilities*** are those possessed uniquely by one organisation or only by a **few** others.
- Rarity could be ***temporary***.



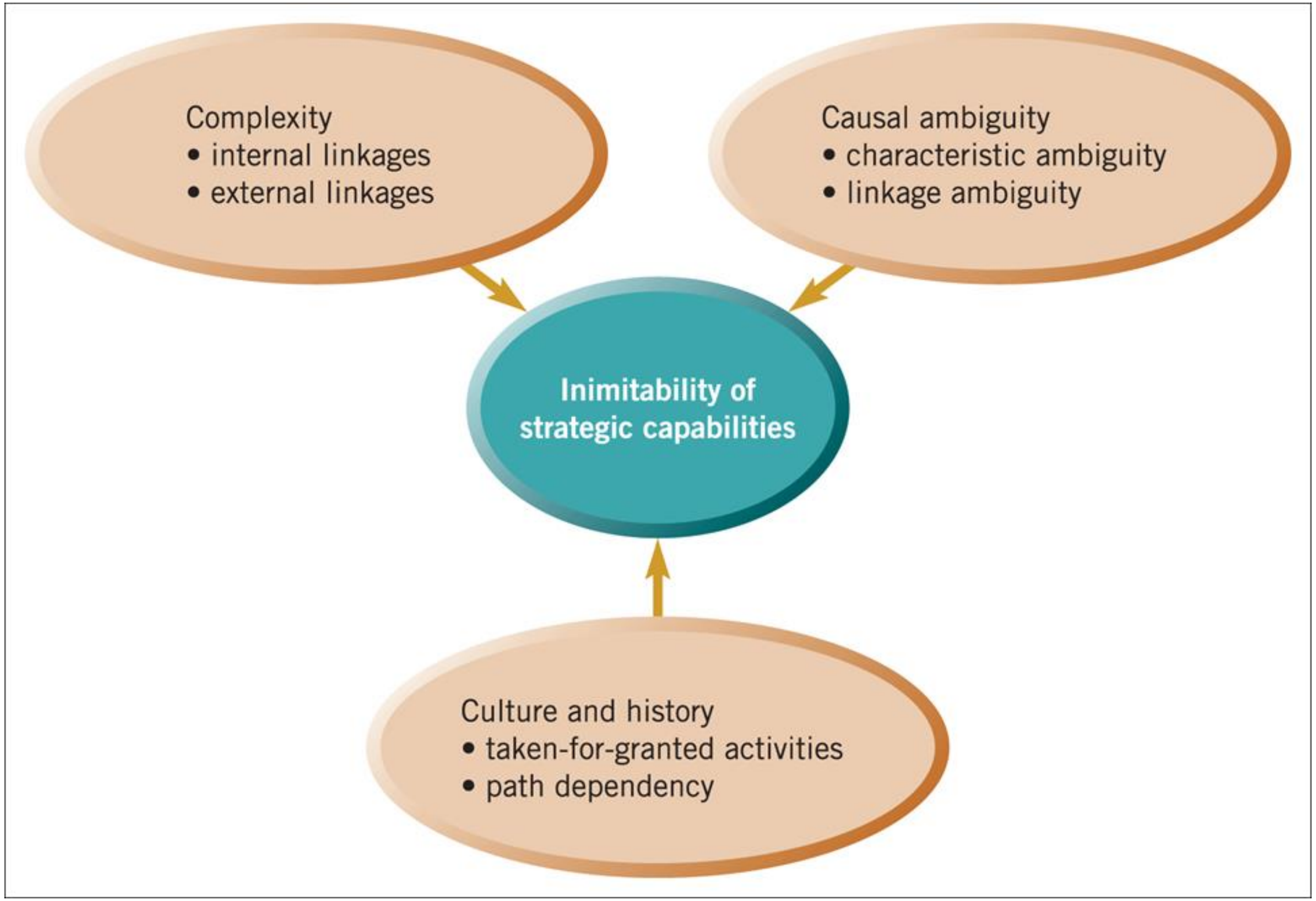
The VRIO Framework: Imitability

Easier to imitate tangible resources/capabilities than intangible ones

- Why is imitation so difficult?
  - ➢Hard to acquire in a short time what competitors have developed over a long time
  - ➢Events earlier in time affect future events
  - ➢Difficult to identify causal determinants of performance
- Valuable, rare, but imitable resources/capabilities = temporary advantage
- Only valuable, rare and hard-to-imitate resources/capabilities = sustained competitive advantage.

Inimitability

Inimitable capabilities are those that competitors find **difficult** and costly to imitate, to obtain or to substitute.



Inimitability

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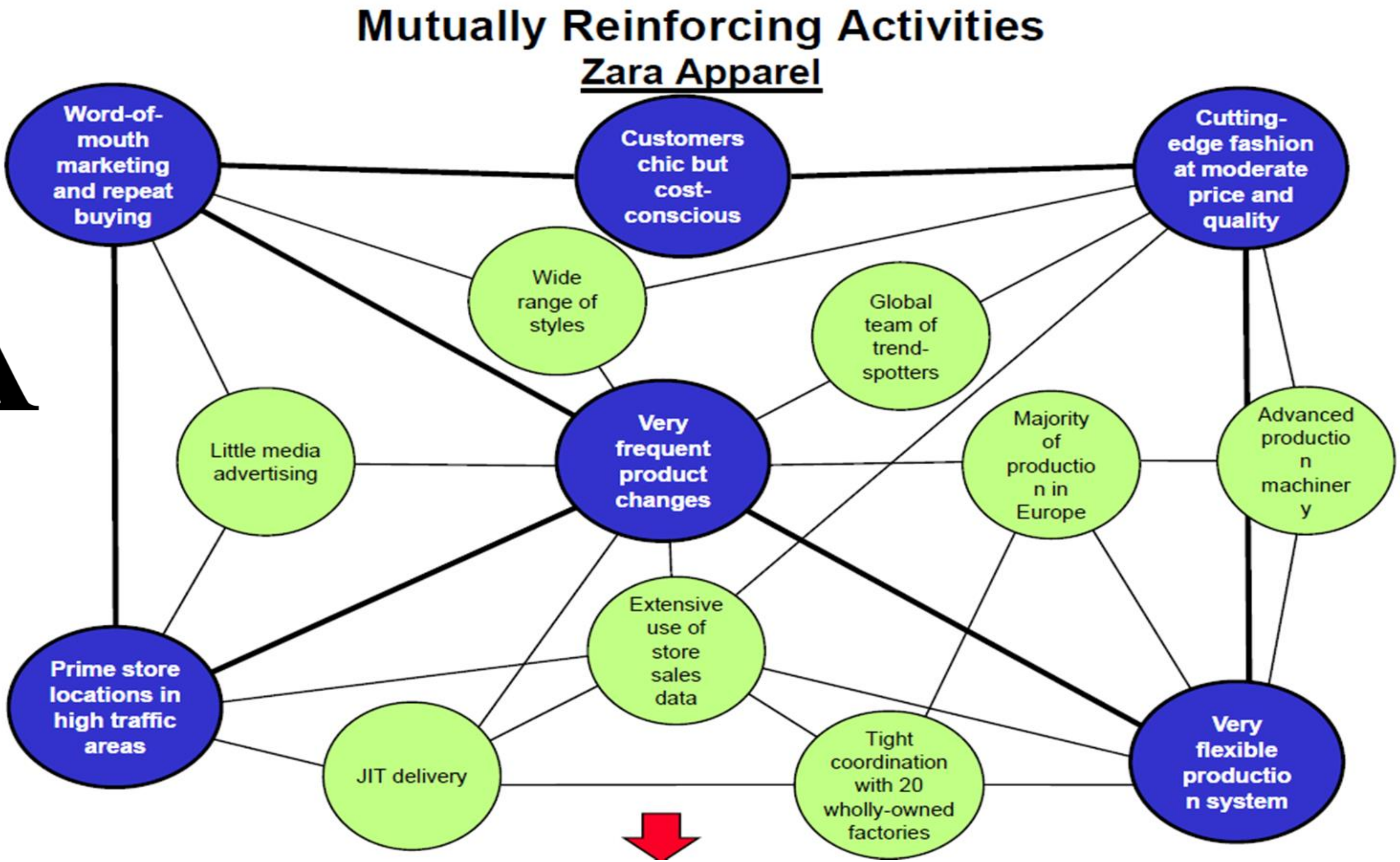

The VRIO Framework: Organization

The Question of Organization

How is a firm organized to develop and leverage the full potential of its resources and capabilities?

Using complementary assets effectively

Managing social complexity effectively

- Invisible relationships can add value - make imitation more difficult

The VRIO Framework: Is a Resource or Capability?

VALUABLE?	RARE?	COSTLY TO IMITATE?	EXPLOITED BY ORG.	COMPETITIVE IMPLICATIONS	FIRM PERFORMANCE
No	—	—	No	Competitive disadvantage	Below average
Yes	No	—	Yes	Competitive parity	Average
Yes	Yes	No	Yes	Temporary competitive advantage	Above average
Yes	Yes	Yes	Yes	Sustained competitive advantage	Consistently above average

Sources: Adapted from (1) J. Barney, 2002, Gaining and Sustaining Competitive Advantage, 2nd ed. (p. 173), Upper Saddle River, NJ: Prentice Hall; (2) R. Hoskisson, M. Hitt, & R. D. Ireland, 2004, Competing for Advantage (p. 118), Cincinnati: South-Western Cengage Learning..

Resources, Capabilities, and the Value Chain

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Value Chain

The functional activities within the firm that create value in the goods and services produced

Components of the Value Chain

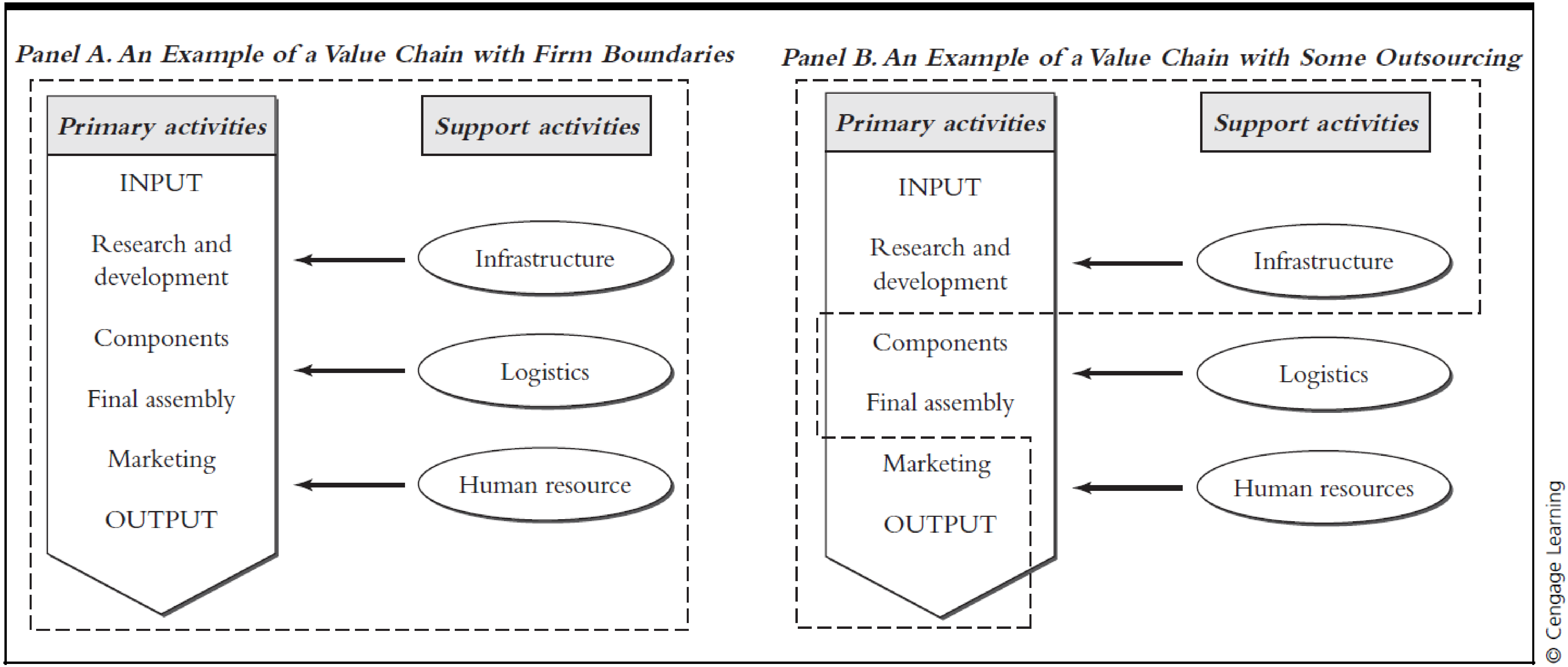
Primary activities

Are directly associated with the development, production, and distribution of goods and services

Support activities

Assist in the accomplishment of primary activities

The Value Chain



Note: Dotted lines represent firm boundaries.

VRIO Research in HRM

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- Kim, J., & Makadok, R. (2021). Unpacking the “O” in VRIO: The role of workflow interdependence in the loss and replacement of strategic human capital. Strategic Management Journal.

DOI: 10.1002/smj.3358

SPECIAL ISSUE ARTICLE

WILEY

Unpacking the “O” in VRIO: The role of workflow interdependence in the loss and replacement of strategic human capital

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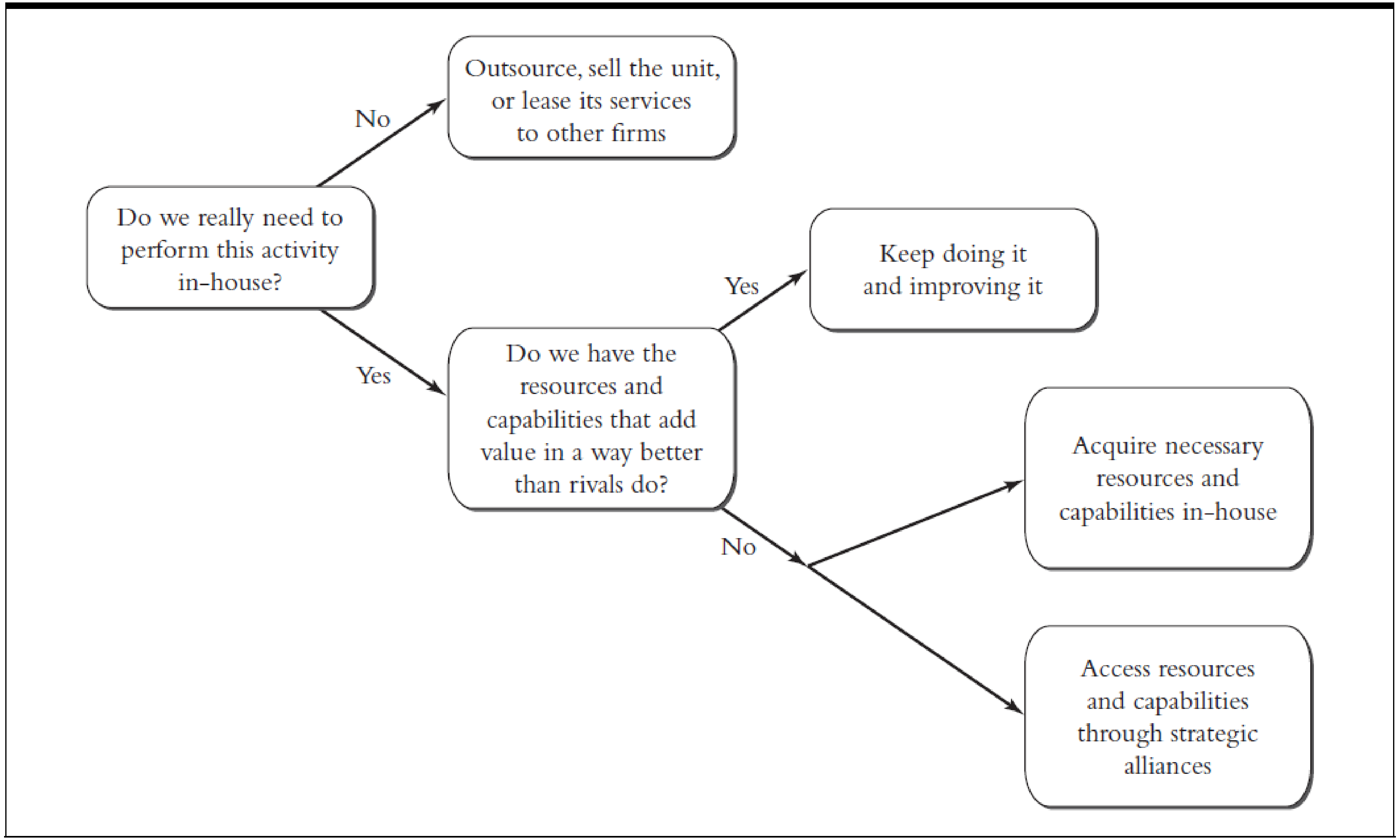
Abstract

Research Summary: An underresearched and undertheorized factor in the resource-based view's VRIO acronym is the “O”: organizational deployment. Exploiting a rule change that exogenously shifted the workflow interdependence of NBA basketball teams, we examine how the benefit provided by a resource depends upon the way it is deployed in an organization's workflow. We also examine how workflow interdependence influences the relative effectiveness of two capabilities for obtaining resources—external acquisition versus internal development. We find that losing star players is more damaging under conditions of greater pooled interdependence and that external acquisition capabilities are more effective for mitigating this damage. Conversely, we find that losing non-star players is more damaging under conditions of greater reciprocal interdependence and that internal development capabilities are more effective for mitigating this damage.

Managerial Summary: Different organizations arrange their workflows in different ways. Some organizations use more individual-focused workflows, where the performance of each employee is relatively independent of the performance of coworkers, while others use more team-focused workflows, where the performance of each employee depends critically on the performance of coworkers. Does an organization's way of arranging its workflow affect the amount of damage done when a key

Strat Mgmt J. 2021;1–35. wileyonlinelibrary.com/journal/smj 1

A Decision Model in Value Chain Analysis



Social Network Theory

Social network theory

- Social Network Theory is the study of how people, organizations or groups interact with others inside their network (Claywell, 2016). It describes the structure and properties of the interactional links between the individuals that comprise a social network (Pataraia, Margaryan, Falconer, Littlejohn & Falconer, 2013).
- Networks are located at the meso-level. They are located between the individual (micro-level) and the institutions (macro-level).
- The theories assume an interaction between individual and their networks, with the focus on relationships and their structures.
- There is not a single network theory. Instead, there are lots of different theories or theoretical concepts.

Social Network Theory: application

Social Network Theory

SNT is a way to account for the social connections that an individual employs to reach valued information.
From: Encyclopedia of Social Measurement, 2005

Related terms:

Mental Health, Self-Efficacy, Cognitive Representation, Ego, Adolescents, Public Health, Social Learning

View all Topics

Can Informal Networks Positively Influence Economic Growth and Development? The Case of South Korean Yongo Networks

K. Restel, S. Horak, in Business Networks in East Asian Capitalisms, 2017

Abstract

Conventionally, the influence of informal networks is considered a

Information Management

Paul T. Jaeger, ... Charles R. McClure, in Encyclopedia of Social Measurement, 2005

Information Behavior

Information behavior is an individual's action (or inaction) when faced with an information need. The range of information behaviors includes deciding that information is needed, searching for information when desired information is not present, sharing or suppressing information once discovered, avoiding information,

Theoretical application of Social Network Theory in IB

- A social network is defined as “a finite set or sets of actors and the relation or relations defined on them” (Wasserman and Faust, 1994, p. 20).
- The actors (nodes) in social network analysis can represent different levels of any kind of social unit such as individuals, firms,organizations (Contractor et al., 2006; Borgatti and Li, 2009).
- A main purpose of social network theorizing is to explain network consequence.
- The majority of network theorizing deals with network ties primarily as flows of information and knowledge.

Yamin, M., & Kurt, Y. (2018). Revisiting the Uppsala internationalization model: Social network theory and overcoming the liability of outsidership. International Marketing Review.

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Revisiting the Uppsala internationalization model

Social network theory and overcoming the liability of outsidership

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Received 3 November 2014
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14 July 2015
9 July 2016
10 October 2016
5 February 2017
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Abstract

Purpose – The purpose of this paper is to utilize key insights from social network theory (SNT) to enhance understanding of overcoming the liability of outsidership as a prerequisite for firm internationalization. Specifically, it examines the influence of structural attributes of networks on the motivational stance of both network insiders and outsiders in relation to overcoming the liability of outsidership. A related aim is to explore the role of network positions of insider actors in terms of its impact on the speed of market entry.

Design/methodology/approach – The paper draws on the extant literatures on firm internationalization, particularly the liability of outsidership, and SNT to identify to what extent SNT can be utilized to deeply understand the process of overcoming the liability of outsidership. The authors put forward eight propositions linking structural and positioning attributes of networks with overcoming the liability of outsidership.

Findings – SNT provides strong potential for a more comprehensive understanding of the internationalization phenomena through shedding light on the relationship between the liability of foreignness and the liability of outsidership. The paper demonstrates that while the cost of overcoming the liability of outsidership is higher in closed target network as compared to open networks, the expected benefits of an insidership position in closed or open networks are affected by the outsider firm’s perception of the liability of foreignness in the market it wishes to enter. Considering the differential enabling characteristics of closed and open networks in terms of facilitating tacit knowledge sharing as opposed to explicit information flows, the authors reveal that liability of foreignness operates as a negative moderator for the relationship between network structure and the willingness of the outsider to invest in gaining insidership. The analysis of the paper also shows that the positional attributes of the network insider are relevant in outsiders’ motivation in terms of the speed of market entry that they seek to achieve.

Originality/value – This study theoretically contributes to the internationalization research through integrating SNT with the liability of outsidership understanding of firm internationalization. This is a timely attempt as no systematic application of the conceptual apparatus of SNT in the internationalization research context has been studied. It adds a more coherent inside-out perspective into the overcoming the liability of outsidership discussion which has been extensively dominated by an outside-in perspective.

Keywords Social network theory, Uppsala model, Market entry, Internationalization, Liability of foreignness, Liability of outsidership, Network structure

Paper type Conceptual paper

1. Introduction

The literature on firm internationalization, particularly that focusing on SME internationalization and international new ventures, has highlighted the importance of network linkages in the internationalization process (e.g. Johanson and Vahlne, 2009; Larson and Starr, 1993; Loane and Bell, 2006; Coviello, 2006; Ojala, 2009; Gabrielsson *et al.*, 2008). In their revised Uppsala model, Johanson and Vahlne (2009) provided an important and influential contribution by articulating the proposition that the main impediment for internationalization is the liability of network outsidership rather than the liability of foreignness. However, despite the increasing emphasis on the network concept in the internationalization research, there is little connection thus far between the literature on internationalization and social network theory (SNT). To our knowledge, no systematic application of the conceptual apparatus of SNT in the

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DOI 10.1108/IMR-11-2014-0345

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Theoretical application of Social Network Theory in HRM

- Soltis, S.M., Brass, D.J. and Lepak, D.P., 2018. Social resource management: Integrating social network theory and human resource management. Academy of Management Annals, 12(2), pp.537-573.

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2018, Vol. 12, No. 2, 537–573.
https://doi.org/10.5465/annals.2016.0094

SOCIAL RESOURCE MANAGEMENT: INTEGRATING SOCIAL NETWORK THEORY AND HUMAN RESOURCE MANAGEMENT

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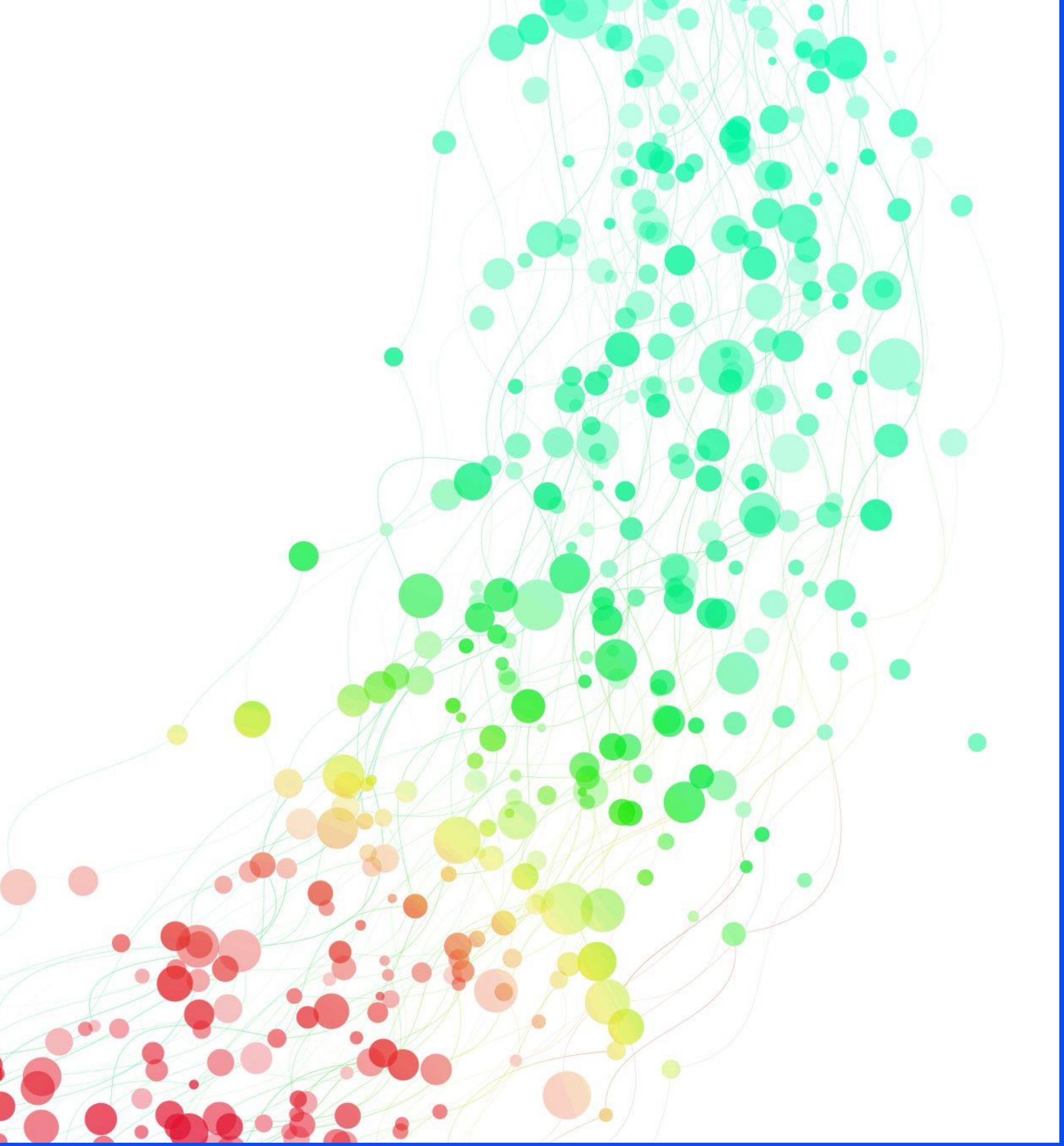
Although social network analysis has become a staple of research in organizational behavior, organizational theory, and strategic management, integration and utilization of this perspective has been much slower in the area of human resource management. We attempt to nudge the study of human resources management toward "Social Resource Management"—adding the social network perspective to research and practice. We discuss how a social network perspective informs managing employee competencies (recruitment, selection, training, and development), managing employee behaviors and attitudes (performance management, compensation, turnover, and retention), and managing employees for competitive advantage (strategic human resource management and strategic human capital). Our goals are twofold: provide a summary of existing research relevant to human resource management that employs a social network perspective and stimulate future work in social resource management. We provide guidance to ensure that work in this area does not simply apply the label of a social network perspective, but rather meaningfully integrates the two fields.

Human resource management research has a long and honored tradition of focusing on the measurement of human capital—the knowledge, skills, abilities and other characteristics of individuals (KSAOs)—and relating human capital to important organizational outcomes. Yet, to focus on the individual in isolation is at best capturing only part of the variance. As Hollenbeck and Jamieson (2015: 370) recently noted, "many of the phenomena and outcomes related to human capital, such as recruiting and onboarding, teamwork and communication, knowledge management, and employee satisfaction are…dependent on social capital and the relational networks that exist among employees." Social capital refers to the idea that one's social contacts convey benefits that create opportunities for competitive success for individuals and for the groups in which they are members. Individuals are embedded in networks of interrelationships that provide opportunities and constraints on behavior.

Despite the clear synergies, Hollenbeck and Jamieson (2015: 371) also lament that "social network analysis is gaining a foothold in the management literature, and researchers are beginning to explore how organizational network ties are formed and how these ties affect other organizational outcomes. To a large extent, however, this approach has not had as much effect on research or practice in the field of human capital management." Our preliminary literature review confirmed Hollenbeck and Jamieson's conclusion. We reviewed three major general management journals (*Academy of Management Journal*, *Organization Science*, and *Journal of Management*), three major journals with an emphasis on human resource management (*Journal of Applied Psychology*, *Personnel Psychology*, and *Human Resource Management*), and two theoretically focused journals (*Academy of Management Review* and *Human Resource Management Review*) focusing on 10 areas as subject terms: job hunting, recruitment, selection, socialization, training, development, performance management, compensation/pay, turnover,

The first two authors wish to express their sympathies for the sudden loss of their co-author David Lepak. Dave's contributions via this manuscript, his other scholarly works, his teaching, and his roles as a mentor, colleague, and friend



Agency Theory

Agency Theory: An Assessment and Review

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. Academy of management review, 14(1), 57-74.

Table 1
Agency Theory Overview

Key idea	Principal-agent relationships should reflect efficient organization of information and risk-bearing costs
Unit of analysis	Contract between principal and agent
Human assumptions	Self-interest Bounded rationality Risk aversion
Organizational assumptions	Partial goal conflict among participants Efficiency as the effectiveness criterion Information asymmetry between principal and agent
Information assumption	Information as a purchasable commodity
Contracting problems	Agency (moral hazard and adverse selection) Risk sharing
Problem domain	Relationships in which the principal and agent have partly differing goals and risk preferences (e.g., compensation, regulation, leadership, impression management, whistle-blowing, vertical integration, transfer pricing)

© Academy of Management Review, 1989, Vol. 14, No. 1, 57–74.

Agency Theory: An Assessment and Review

KATHLEEN M. EISENHARDT
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Agency theory is an important, yet controversial, theory. This paper reviews agency theory, its contributions to organization theory, and the extant empirical work and develops testable propositions. The conclusions are that agency theory (a) offers unique insight into information systems, outcome uncertainty, incentives, and risk and (b) is an empirically valid perspective, particularly when coupled with complementary perspectives. The principal recommendation is to incorporate an agency perspective in studies of the many problems having a cooperative structure.

One day Deng Xiaoping decided to take his grandson to visit Mao. "Call me granduncle," Mao offered warmly. "Oh, I certainly couldn't do that, Chairman Mao," the awe-struck child replied. "Why don't you give him an apple?" suggested Deng. No sooner had Mao done so than the boy happily chirped, "Oh thank you, Granduncle." "You see," said Deng, "what incentives can achieve." ("Capitalism," 1984, p. 62)

Agency theory has been used by scholars in accounting (e.g., Demski & Feltham, 1978), economics (e.g., Spence & Zeckhauser, 1971), finance (e.g., Fama, 1980), marketing (e.g., Basu, Lal, Srinivasan, & Staelin, 1985), political science (e.g., Mitnick, 1986), organizational behavior (e.g., Eisenhardt, 1985, 1988; Kosnik, 1987), and sociology (e.g., Eccles, 1985; White, 1985). Yet, it is still surrounded by controversy. Its proponents argue that a revolution is at hand and that "the foundation for a powerful theory of organizations is being put into place" (Jensen, 1983, p. 324). Its detractors call it trivial, dehumanizing, and even "dangerous" (Perrow, 1986, p. 235).

Which is it: grand theory or great sham? The purposes of this paper are to describe agency theory and to indicate ways in which organizational researchers can use its insights. The paper is organized around four questions that are germane to organizational research. The first asks the deceptively simple question, What is agency theory? Often, the technical style, mathematics, and tautological reasoning of the agency literature can obscure the theory. Moreover, the agency literature is split into two camps (Jensen, 1983), leading to differences in interpretation. For example, Barney and Ouchi (1986) argued that agency theory emphasizes how capital markets can affect the firm, whereas other authors made no reference to capital markets at all (Anderson, 1985; Demski & Feltham, 1978; Eccles, 1985; Eisenhardt, 1985).

The second question is, What does agency theory contribute to organizational theory? Proponents such as Ross (1973, p. 134) argued that "examples of agency are universal." Yet other scholars such as Perrow (1986) claimed that agency theory addresses no clear problems, and Hirsch and Friedman (1986) called it excessively narrow, focusing only on stock price. For economists, long accustomed to treating the or-

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Agency Theory

Stefan Linder, Nicolai J. Foss, in
International Encyclopedia of the Social & Behavioral Sciences (Second Edition)
, 2015

Abstract

Agency theory studies the problems and solutions linked to delegation of tasks from principals to agents in the context of conflicting interests between the parties. Beginning from clear assumptions about rationality, contracting, and informational conditions, the theory addresses problems of ex ante ('hidden characteristics') as well as ex post information asymmetry ('hidden action'), and examines conditions under which various kinds of incentive instruments and monitoring arrangements can be deployed to minimize the welfare loss. Its clear predictions and broad applicability have allowed agency theory to enjoy considerable scientific impact on social science; however, it has also attracted considerable criticism.

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Blockchain-enabled humanitarian supply chain management: sustainability and responsibility

The analytical background

In Guerilla Capitalism, 2009

1.2 Principal / agent theory

Agency theory can offer some insights into the management behaviour of SOEs in Vietnam, since the heart of the enterprise reform programme is, by and large, about incentive structure, authority delegation and decentralisation (see Chapter 5). This primarily involves the relation between two parties: the government (principal) and the enterprise (agent).

Agency theory is rooted in one of the oldest problems of political philosophy, that of understanding the relation between the 'master' who is given socially legitimate control over certain actions and the 'servant' who controls the information on which the 'master' acts (Cyert and March, 1992). Berle and Means (1932) introduced the theory to the context of the modern firm where ownership and management is separated. The theory has developed substantially since the 1960s and 1970s (Eisenhardt, 1989) and became centrally concerned with the relationship between two contracting parties. Jensen and Mickling (1976) define an agency relationship as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent" (p.333). The theory assumes that both the principal and the agent are utility maximizers with different interests, and that because of information asymmetry the agent will not always act in the best interests of the principal. The principal can limit the divergence of interest by establishing appropriate incentives for the agent and by incurring costs termed *agency costs* (Jensen and Mickling, 1976). Agency costs include: (1) monitoring expenditure by the principal to

Agency theory

Principal-agent theory shares TC concepts of **uncertainty, opportunism, externalization, cost-efficiency calculations**

Principal pays Agent to perform service in exchange for fee

EX: Hollywood & sports agents negotiate contracts for stars

Information asymmetry: How does Principal know if Agent is competent and working on behalf of Principal's interests? (If P had necessary knowledge and skills, A would be unnecessary)

Agency costs: Principal's search, monitoring, bonding costs to hire and supervise Agent (vs Principal doing the job herself)

Opportunism (moral hazard): Risk-averse Agent tempted to deceive & shirk duties; pocket fee but not deliver the best deal

Why does the agency problem arise?

Separation of ownership from control produces a condition where the interests of owner(s) and managers often diverge and discretionary power by managers exists (Berle, A. and Means, G., 1932. Private property and the modern corporation. New York: Mac-Millan)

First, the agency problem arises when:

(a) Incentives of the Principal and Agent are not aligned

(b) Information Asymmetry Moral Hazard Adverse Selection

Secondly, the problem of risk sharing arises when:

Principal and Agent have different risk preferences

Principal may be risk-averse but agent may be risk-seeking

Agency theory

- If a firm is a sole proprietorship managed by the owner, the owner-manager will undertake actions to maximize his or her own welfare.
- A potential agency conflict arises whenever the manager of a firm owns less than 100 percent of the firm's common stock.
- Agency costs are defined as those costs borne by shareholders to encourage managers to maximize shareholder wealth rather than behave in their own self-interests.
- Agency theory suggests that, in imperfect labour and capital markets, managers will seek to maximize their own utility at the expense of corporate shareholders.

Agency theory

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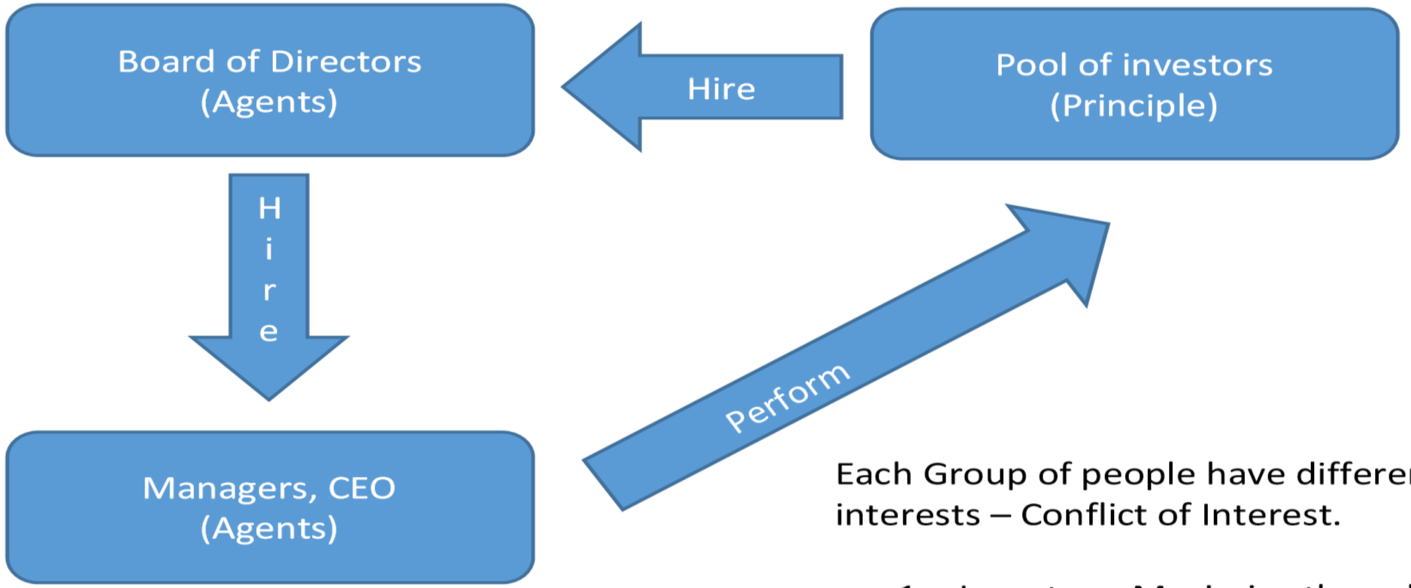
Agents appointed by pool of investors/ shareholders during annual general meeting (AGM's)
Role: Monitor the Managers

True owners of the business



Each Group of people have different interests – Conflict of Interest.

1. Investors: Maximize the value of share
2. Board of directors: maximize personal profits as they are in an influential position
3. Managers: Maximize personal gains as they have more knowledge and information on the operation of business

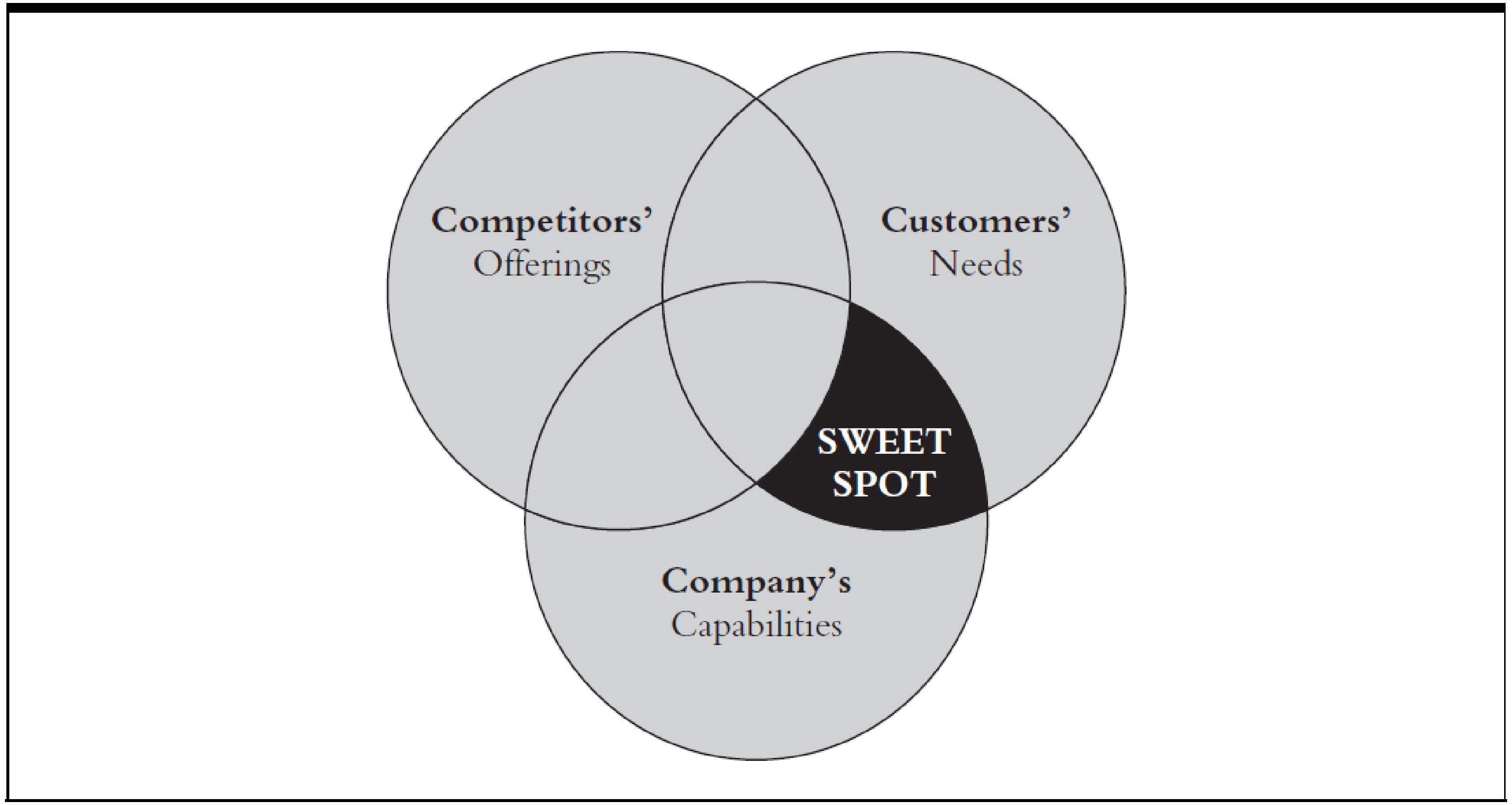
Agents appointed by the Board of Directors to run the business.
Role: operate the business

Solving Agency Problems

- There are three schemes that the principal can approach the agent with, each of which come with a cost of implementation to the principal. These include Carrot mechanism, Stick mechanism and a mix of carrot and stick mechanism.
- **Carrot:** the agent receives a bonus for high effort, at a low cost to the principal. Offer Incentives and Commissions □
- **Stick:** the agent is fired for low effort, a high cost to the principal) or Penalties for the violation of routines to Limit the management discretionary power □
- **Carrot and Stick:** the agent is given a bonus for a high effort but is also threatened to be fired if the effort is low, a mix of low and high cost to the principal

Strategic Sweet Spot

Strategic sweet spot is "where it meets customer's needs in a way that rivals can't, given the context in which it competes" (Collis and Rukstad, 2008:7).



Source: D. Collis & M. Rukstad, 2008, Can you say what your strategy is? (p. 89), *Harvard Business Review,* April: 82–90.

Theoretical Perspectives

- **The resource-based view** of the firm suggests that sources of competitive advantage are to be found inside the firms and that managers should protect, nurture and leverage these sources.
- **Industrial-organization economics**, on the other hand, suggests that what matters most is the structure of the industry and therefore managers should ensure that they monitor and try to manipulate the structural forces that surround or may surround them.
- **Transaction cost economics** explains how firms can define and choose an efficient structure that would minimize overall costs.
- Jenkins, Mark, Ambrosini, Veronique and Collier, Nardine (2016). *Advanced Strategic Management: A Multi-Perspective Approach* (3rd edn). Palgrave Macmillan.

Other Theoretical Perspectives

- **Game theory** justifies why it is essential for firms to observe the players in their industry and how they interact in order to achieve the most favourable position.
- **Institutional theory** warns that managers need to be aware of the influence of their environment, how it may pressure their organization to conform to the rules of the game, and therefore managers may not be able to change and create as free of constraints as they may think.
- **The cognitive perspective** highlights that managers' rationality is often limited, that they may rely on simplified representations of the world surrounding them and that managers should be aware of these as how they think and make sense of their world that has an effect on the strategic decision they make.

Transaction Cost Theory

Ronald Coase (1937) posed two Nobel-prize puzzles :

Why do **any** firms emerge in a market economy?

Why not just **One Big Firm** for whole economy?

Neoclassical economics treats the firm as a production function that efficiently transforms land, labor & capital inputs into goods & services. Competitive markets coordinate buyer-seller exchanges via price signals.

Coase argued that market mechanism **not cost-free**, but involves **transaction costs**: time & money to search for sellers & buyers, negotiate exchange terms, write contracts, inspect results, enforce deals.

Firms will emerge if an “economizing” organization can reduce its production + transaction costs < market prices

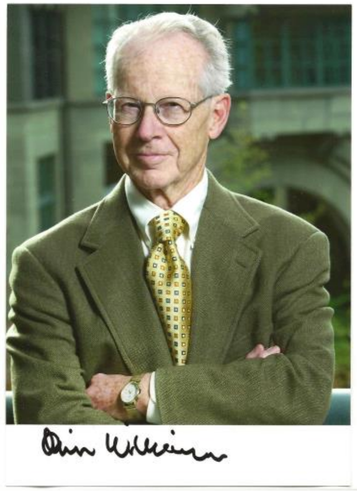
Firm expansion halts when intra-org’l TC > market prices

Transaction Cost Theory

Williamson illustrated TCE theory (1975, 1984) also shaped by **Coase** (1937)

Focusing on firm boundaries, transaction cost theory aims to answer the question of when activities would occur within the market and when they would occur within the firm (Williamson, 1991).

According to Williamson, the determinants of transaction costs are **frequency, specificity, uncertainty, limited rationality, and opportunistic behavior**.



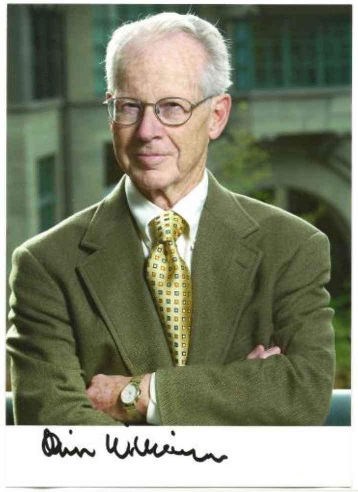
More specifically, transaction cost theory predicts when the governance forms of hierarchies, markets, or hybrids (e.g., alliances) will be used.

Williamson, who was recognized with a Nobel Prize for his work on transaction costs, theorized that whether activities would be internalized within a firm depended on their transaction costs.

Transaction cost theory is built on assumptions of **bounded rationality** and **opportunism**, defined as **self-interest** with guile.

Transaction Cost Theory

Oliver Williamson (1975, 1981) identified three fundamental forms of transaction governance and the conditions when they're likely to occur:



Market: Autonomous parties' exchanges are governed by prices in supply-demand equilibrium

Hierarchy: (Formal org) Transactions among parties occur under a unified owner, who settles disputes by administrative fiat

Hybrid: "Long-term contractual relations that preserve [parties'] autonomy, but provide added transaction-specific safeguards as compared with the market."

EX: United Way and social service agencies

Strategic alliances; agricultural cooperatives

Networks of small-medium suppliers and manufacturers

Transaction Cost Theory

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Behavioral Assumptions

Transaction parties can never write completely detailed agreements covering all possible future contingencies (“incomplete contracting”)

Williamson assumed transactors’ abilities & motives involve:

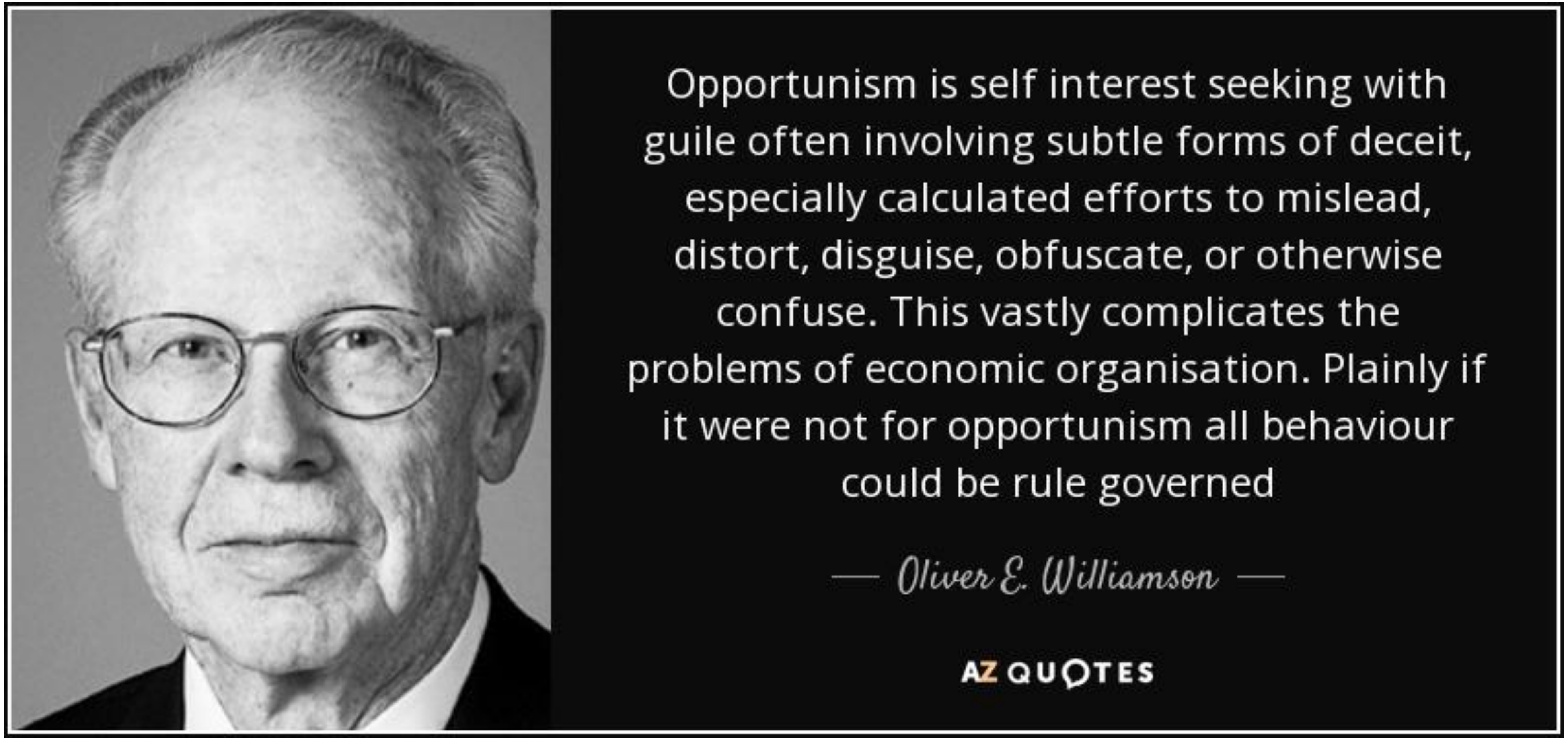
Bounded rationality: Utility-maximizing, intendedly rational transactors are constrained by cognitive limits on their capacities to process information efficiently (contrast to neoclassical perfect information)

Opportunism: “Self-interest with guile” could induce strategic behavior by transactors to lie to, cheat, confuse, mislead their exchange partners

EX: Used car salesmen; political candidates; your study group?

Even when opportunism risks are low, orgnizations must still safeguard against possibly severe damages from an opportunistic partner (worst case scenario)

Transaction Cost Theory



Transaction Cost Theory: an overview at Science Direct

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Henrich R. Greve, Linda Argote, in International Encyclopedia of the Social & Behavioral Sciences (Second Edition), 2015

Transaction Cost Theory

Focusing on firm boundaries, transaction cost theory aims to answer the question of when activities would occur within the market and when they would occur within the firm (Williamson, 1991). More specifically, transaction cost theory predicts when the governance forms of hierarchies, markets, or hybrids (e.g., alliances) will be used. Williamson, who was recognized with a Nobel Prize for his work on transaction costs, theorized that whether activities would be internalized within a firm depended on their transaction costs. He saw transactions broadly as transfers of goods or services across interfaces, and argued that when transaction costs were high, internalizing the transaction within a hierarchy was the appropriate decision. Conversely, when transaction costs were low, buying the good or service on the market was the preferred option. Three dimensions were developed for characterizing transactions: uncertainty, frequency, and asset specificity, or the degree to which transaction-specific expenses were incurred. Transaction cost theory is built on assumptions of bounded rationality and opportunism, defined as self-interest with guile.

A review of the empirical literature on transaction cost theory

Waves of disruption have undermined but not defeated globalization

Michela Pellicelli, in The Digital Transformation of Supply Chain Management, 2023

6.2.1 The need for a constant review of core competences

The growing popularity of outsourcing, which has moved companies to transfer more and more activities, processes, and entire functions abroad, has presented management with the problem of determining the unique 'core' competencies that distinguish a company from the competition and which therefore cannot be handed over to third parties without running the risk of being imitated and succumbing to competition.

Identifying the core competencies means drawing a line between these and the non-core competencies, which is the first step in defending companies against erosion from the competition and, above all, from changes in the economic, technological, and legal environment. It is rare for the boundaries of the core competencies to remain stable for a long. Every important change in the outsourcing environment and market prompts outsourcers to ask what to outsource and how to do this with providers. The needs of customers are changing, there are more generic products, and more services have become factors for market differentiation. Most providers upgrade their products continuously and extend their range of services, becoming strong competitors not only in their market of origin.

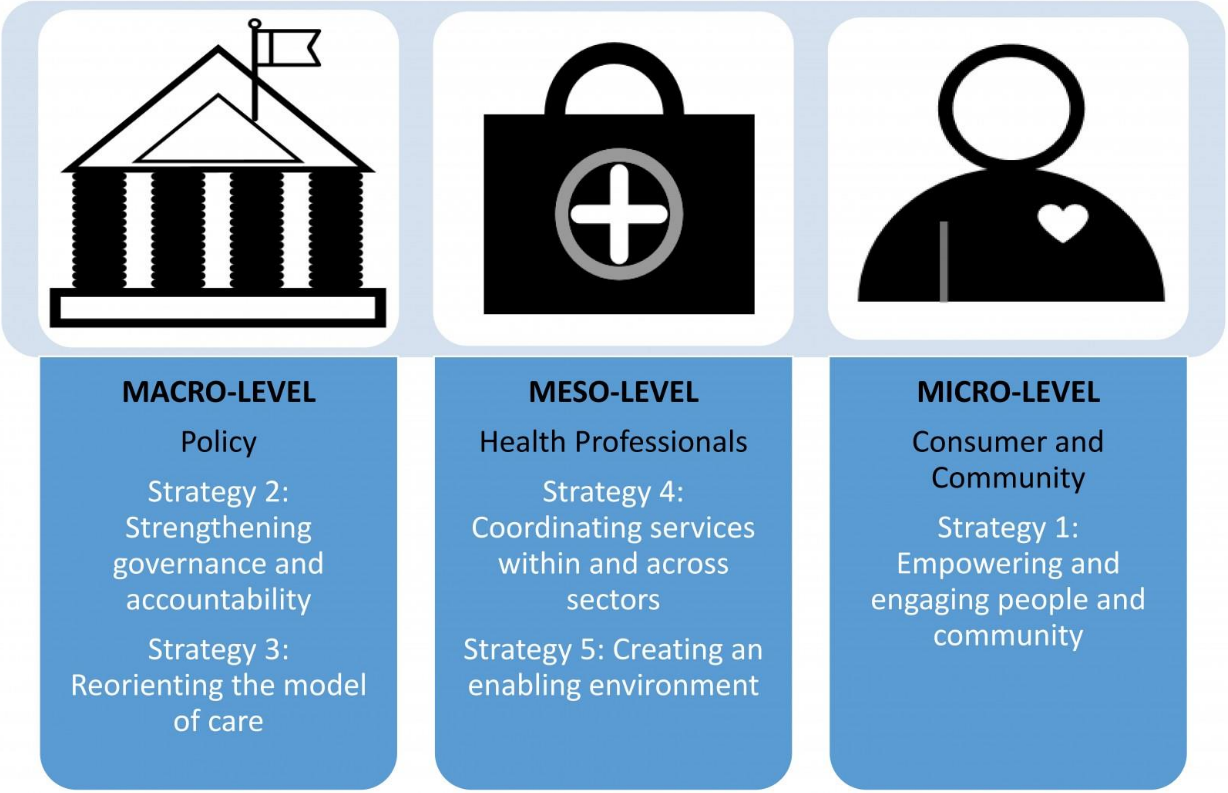
Make or Buy ?

Transaction cost theory examines the conditions under which organizations chose to internalize some functions (hierarchy) or to purchase them on the market (e.g., relational subcontracting)

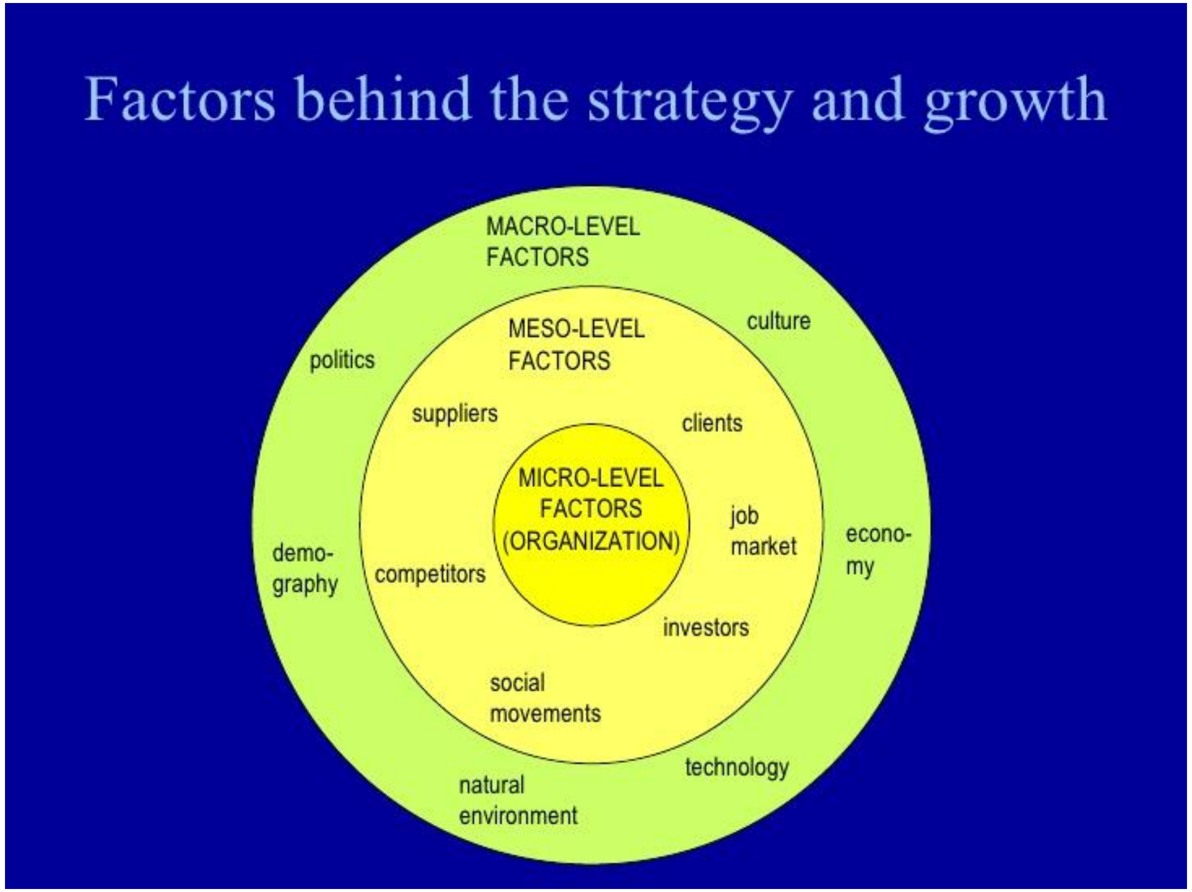
EX When should a firm or agency train its own employees, hire an external vendor (college or commercial), or create a jointly staffed program?

- Are employee job skill requirements changing rapidly & unpredictably?
- How often must newly hired or promoted workers be (re)trained?
- Would the organisation's own training staff have to invest heavily in asset-specific facilities, such as simulation labs?
- Is the organisation's own training staff more knowledgeable than external trainers about firm-specific and tacit skills needed by employees?
- Are external vendors competent, reliable & cost-efficient?

What models/tools would you apply to analyze the macro, micro and meso environments?



Organizational environment



So what is the relationship between some of the theories and models

Macro analysis: Institutional theory; industrial-organization economics (five forces); PESTLE analysis.

Meso analysis: Resource-based view (VRIO framework).

Micro: Cognitive perspective, Motivational theories (performance management)

Where does Stakeholder theory fit?

Some theories combine multiple perspective. Agency theory, for example, blends motivational aspects and regulations.

Any questions?

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