

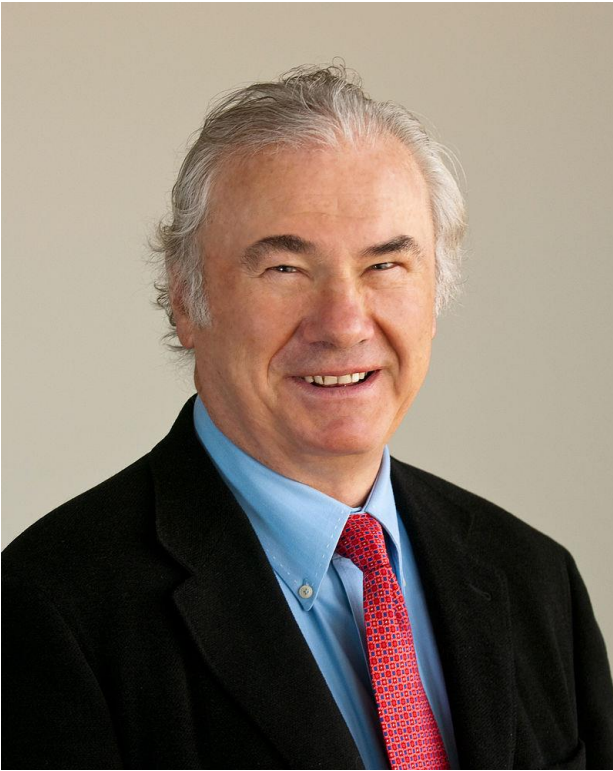
THE DYNAMIC CAPABILITY AND INSTITUTIONAL VIEW OF THE MNC

Lecture 3
Multinational Corporations: Theory and Practice
Winter term 2023/24

Strategic Leadership and Global Management
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Note: The content of this file is released exclusively to support teaching in the context of the module "Multinational Corporations and Corporate Control" in the winter semester 2023/24.

DYNAMIC CAPABILITY VIEW: THE CORE IDEA



David Teece, * 1948

“The essence of the MNE in this prong of literature is less about saving on transaction costs and more about being entrepreneurial and effective in the development, transfer, and orchestration of differentiated organizational and technological capabilities (...).

It is, after all, the potential for synergistic interactions between headquarters and foreign locations (...), with their distinct institutional contexts and capabilities profiles, that distinguishes the MNE case from the general theory of the firm.”

Sources: Teece, D. (2014) A dynamic capability-based entrepreneurial theory of the multinational enterprise. *Journal of International Business Studies* 45, 8-37 (pp. 10), 23.

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SHORTCOMINGS OF NAKED TRANSACTION-COST-BASED THEORIES OF THE MNE (ACCORDING TO TEECE)

- Capabilities and learning unexplored (that is, where do ownership advantages come from?)
- Cross-border market creation and co-creation ignored (market failure approach assumes that [perfect] markets exist, which is not the case)
- Entrepreneurship suppressed, equilibrium assumed, management muted, leadership ignored (international expansion is more than contracting contingent on asset specificity)
- “Control” follows ownership of (foreign) subsidiaries; interfirm-relationships enigmatic (common ownership of business units doesn’t eliminate incentive problems, or does it necessarily achieve control. Conversely, control over the supply chain can also be exercised without ownership)
- Competitive advantage (firm-level heterogeneity) neglected

Source: Teece (2014)

FOUNDATIONS OF A CAPABILITY-BASED VIEW

Core building blocks	Weak ordinary capabilities	Strong ordinary capabilities	Strong dynamic capabilities
Processes (routines)	Sub-par practices	Best practices	Signature practices and business models
Position (resources)	Few ordinary resources	Munificent ordinary resources	VRIN resources
Paths (strategy)	Doing things poorly	Doing things right	Doing the right things (good strategy)

Source: Teece (2014)

A dynamic capability is “the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments” (Teece, D., Pisano, G., & Shuen, A. et al. 1997) Dynamic capabilities and strategic management, SMJ 18(7), 509-533 (516).

Ordinary and dynamic capabilities

“The true source of competitive advantage and sustainable rents arises not from the more embodied and visible elements of the know-how but from the supporting structure, or complementary organizational capabilities around it, that would enable exploitation of this advantage.”

(Madhok, A. (1997), Cost, Value and Foreign Market Entry Mode: The Transaction and the Firm, SMJ 18(1): 39-61, p. 45)

Competitive advantage

Sufficient condition	valuable and rare	inimitable	nonsubstitutable
Necessary condition	Heterogeneous resources		Immobile resources
Basic assumption	Imperfect factor markets		

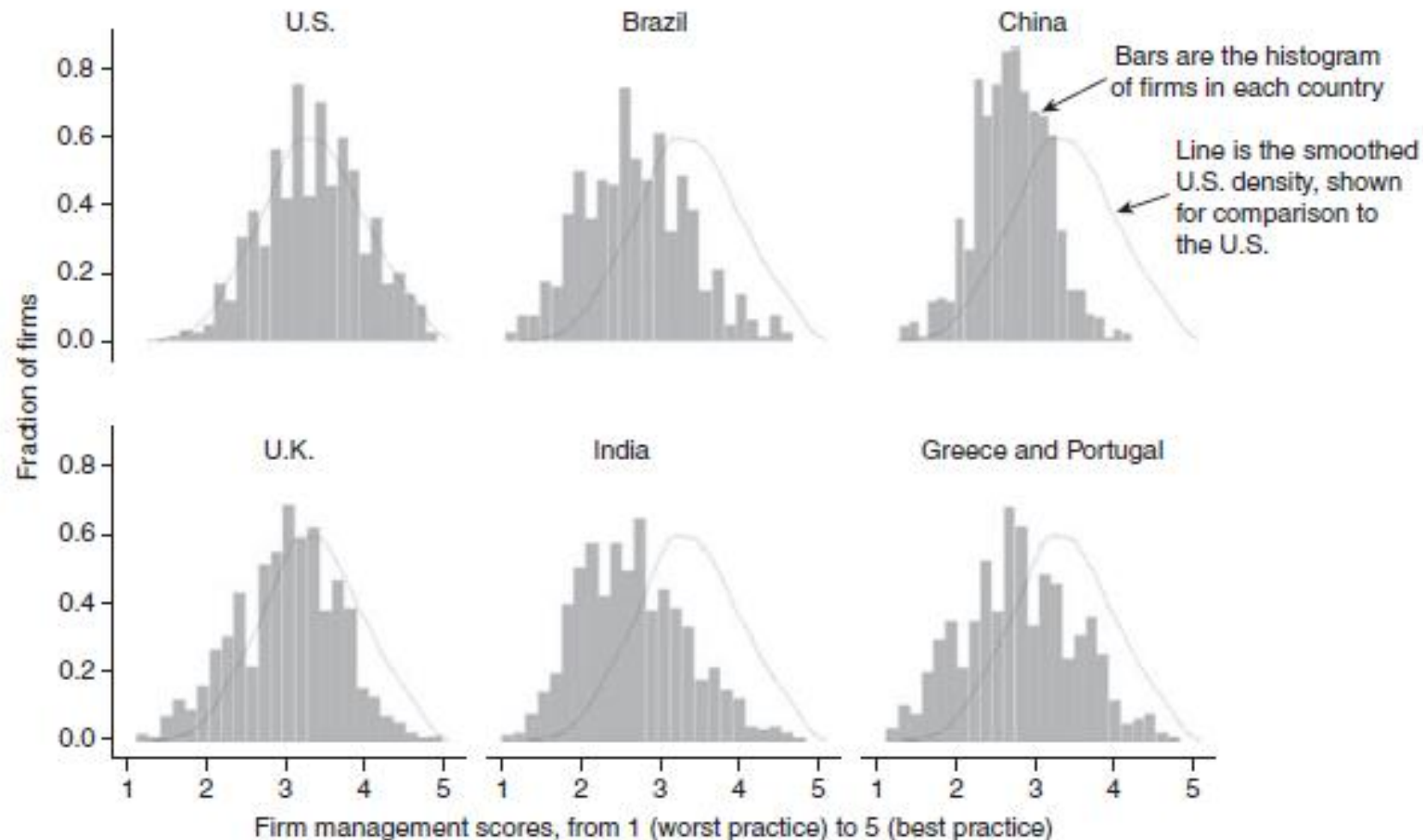
ORDINARY CAPABILITIES: WHAT ARE THEY?

Functional area	Capability	Exemplars
CORPORATE FUNCTIONS	<ul style="list-style-type: none"> Financial control Management development Strategic innovation Multidivisional coordination Acquisition management International management 	<ul style="list-style-type: none"> ExxonMobil, PepsiCo General Electric, Shell Google, Haier Unilever, Shell Cisco Systems, Luxottica Wal-Mart, Capital One, Dell
MANAGEMENT INFORMATION	<ul style="list-style-type: none"> Comprehensive, integrated MIS network linked to managerial decision making 	<ul style="list-style-type: none"> Wal-Mart, Capital One, Dell Computer
RESEARCH AND DEVELOPMENT	<ul style="list-style-type: none"> Research Innovative new product development Fast-cycle new product development 	<ul style="list-style-type: none"> IBM, Merck 3M, Apple Canon, Inditex (Zara)
OPERATIONS	<ul style="list-style-type: none"> Efficiency in volume manufacturing Continuous improvements in operations Flexibility and speed of response 	<ul style="list-style-type: none"> Briggs & Stratton, YKK Toyota, Harley-Davidson Four Seasons Hotels
PRODUCT DESIGN MARKETING	<ul style="list-style-type: none"> Design capability Brand management Building reputation for quality Responsiveness to market trends 	<ul style="list-style-type: none"> Nokia, Apple Procter & Gamble, Altria Johnsen & Johnsen MTV, L'Oreal
SALES AND DISTRIBUTION	<ul style="list-style-type: none"> Effective sales promotion and execution Efficiency and speed of order processing Speed of distribution Customer service 	<ul style="list-style-type: none"> PepsiCo, Pfizer L. L. Bean, Dell Computer Amazon.com Singapore Airlines, Caterpillar

Source: Grant, R. (2013), Contemporary Strategy Analysis, 8th ed., Chichester: John Wiley & Sons, p. 122

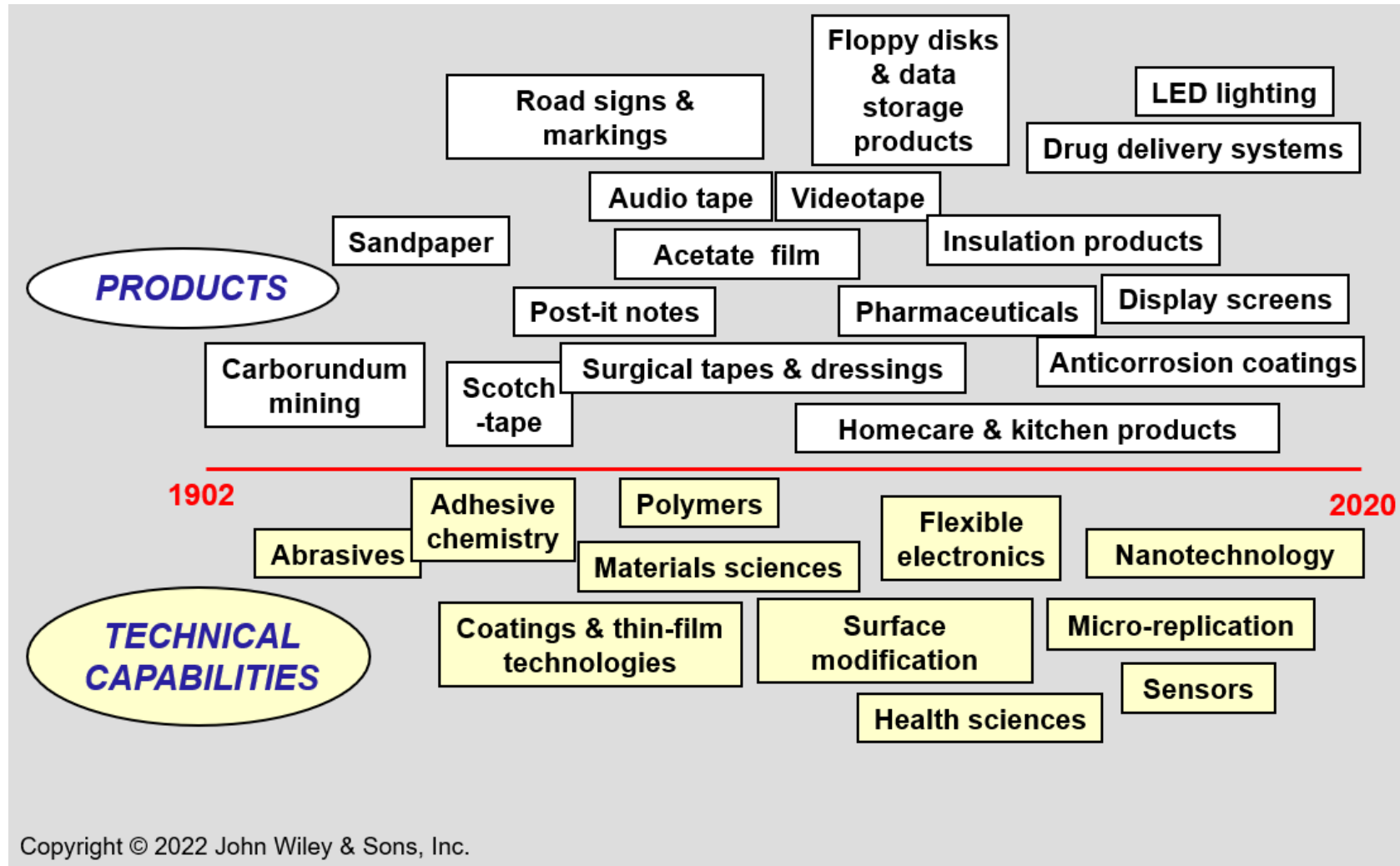
ORDINARY CAPABILITIES: REPLICABLE BUT WITH LIMITATIONS

Best practice diffusion in different countries



Source: Boom, N., Genakos, C., Sadun, R., & Van Reenen, J. (2012) Management practices across firms and countries. *Academy of Management Perspectives* 20(1), 12-33

DYNAMIC CAPABILITIES: WHAT ARE THEY? (1)



Source: Grant, R. (2016), Contemporary Strategy Analysis, 9th ed., Chichester: John Wiley & Sons, p. 117 (taken from the most recent instructor companion site)

DYNAMIC CAPABILITIES: WHAT ARE THEY? (2)

Strategic Capability	Organizational Characteristics	Management Tasks
Global competitiveness	Dispersed and interdependent assets and resources	Legitimizing diverse perspectives and capabilities
Multinational flexibility	Differentiated and specialized subsidiary roles	Developing multiple and flexible coordination processes
Worldwide learning	Joint development and worldwide sharing of knowledge	Building shared vision and individual commitment

Source: Barlett, C. & Ghoshal, S. (1991) Managing Across Borders : The Transnational Solution. Boston MA: Harvard Business School Press, p. 67

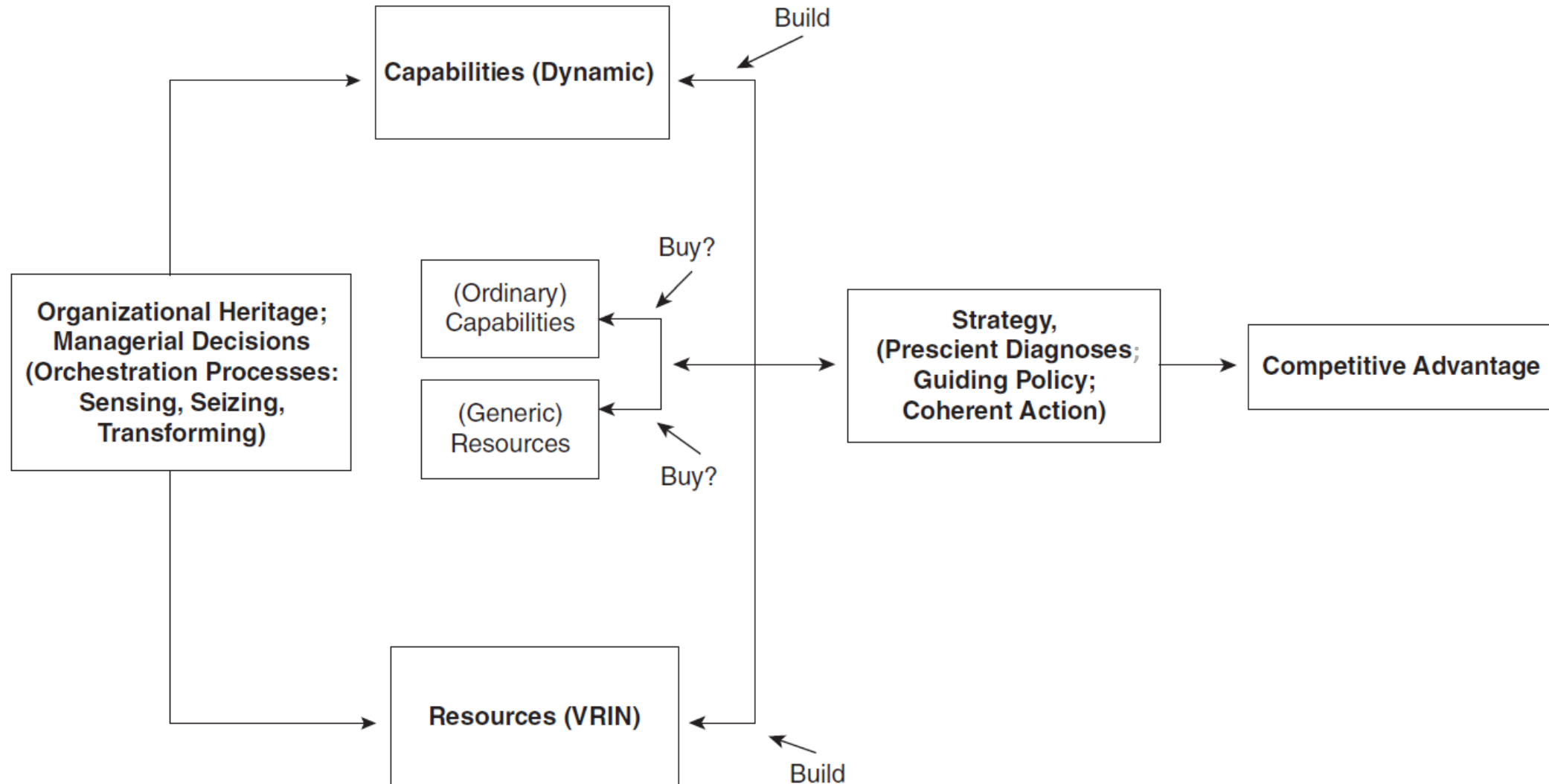
DYNAMIC CAPABILITIES: WHAT ARE THEY? (3)

Capabilities	Importance ^a	VW's relative strength ^b	Comments
C1. Product development	9	4	Traditionally weak at VW. Despite a few big hits: Beetle (introduced 1938), Golf (1974), Vanagon (1979), VW still not an industry leader in new product development
C2. Purchasing	7	5	Traditionally weak – strengthened by senior hires from Opel and elsewhere
C3. Engineering	7	9	The core technical strength of VW
C4. Manufacturing	8	4	VW is a high-cost producer, but struggles to attain above average quality
C5. Financial management	6	4	Has traditionally lacked a strong financial orientation
C6. R&D	5	4	Despite several technical strengths, VW is not a leader in automotive innovation
C7. Marketing and sales	9	4	Despite traditional weakness in recognizing and meeting customer need in different national markets, VW has increased its sensitivity to the market, improved the brand management, and managed its advertising and promotion with increasing dexterity
C8. Government relations	4	8	Important in emerging markets
C9. Strategic management	7	4	Effective restructuring and cost cutting, but lack of consistency and consensus at top management level

^aVolkswagen resources and capabilities are compared with those of GM, Ford, Toyota, DaimlerChrysler, Nissan, Honda, Fiat, and PSA, where 5 represents parity. The ratings based on the author's subjective judgement

Source: Grant, R. (2010), Contemporary Strategy Analysis, 7th ed., Chichester: John Wiley & Sons, p. 141

LOGICAL STRUCTURE OF THE DYNAMIC CAPABILITIES PARADIGM



Source: Teece (2014), p. 22

STRUCTURING COMPETITIVE ADVANTAGES OF AN MNE

Strategic objectives	Sources of competitive advantage		
	National differences	Scale economies	Scope economies
Achieving efficiency in current operations	Benefitting from differences in factor costs—wages and cost of capital	Expanding and exploiting potential scale economies in each activity	Sharing of investments and costs across products, markets and businesses
Managing risks	Managing different kinds of risks arising from market or policy-induced changes in comparative advantages of different countries	Balancing scale with strategic and operational flexibility	Portfolio diversification of risks and creation of options and side-bets
Innovation, learning and adaption	Learning from societal differences in organizational and managerial processes and systems	Benefiting from experience—cost reduction and innovation	Shared learning across organizational components in different products, markets or businesses

Source: Ghoshal, S. (1987) Global Strategy: An Organizing Framework. *Strategic Management Journal* 8 (1987), 425-440 (p.428)

WHERE THE CAPABILITY-BASED VIEW GOES BEYOND INTERNALIZATION THEORY (ACCORDING TO TEECE)

- Answers the question how and when MNEs enter new geographic markets (role of free cash flow and time-cost considerations; “born globals” versus sequencing over time and across different geographical markets)
- Helps to understand the role of headquarters and the subsidiaries within the multinational network (-> see lecture 7)
- Explains global distribution of R&D and innovative ecosystems (e. g., “centers of excellence”)
- Provides a more distinct view on location and “country” factors (by showing how MNEs can benefit from their home country’s “innovation system” as well as exploiting their position vis-à-vis the host country’s institutional structures)

INSTITUTIONAL THEORY AND MNE: BASIC TENETS & CHALLENGES

Theme	Tenet	Challenge
Organizational field	Organizations function in organizational fields, where distinct patterns of organizational action emerge and become institutionalized, institutional pressures are exercised, and legitimacy is granted.	Does the notion of organizational field in the traditional institutional sense really apply to MNCs?
Isomorphism	There is substantial isomorphism (i. e., similarity) among organizations that result from the adoption and diffusion of certain business models, practices, and structures established as a standard in the respective organizational field.	Do MNCs really have to adapt to pressures coming from the host country's institutional environment?
Decoupling and ceremoniality	Organizations engage in ceremonial adoption of institutionalized structures and practices while at the same time decoupling themselves from the environment by actually using different structures and practices they view as more economically efficient.	Do MNCs really need to "hide" their true identity and engage in decoupling and ceremonial adoption?
Legitimacy	Legitimacy (i. e., acceptance and approval of organizational actions by external constituents) is critical for organizational survival. It is achieved primarily through isomorphism, where organizations become similar to other organizations in their organizational field.	Given that MNCs engage in actor-specific manipulation and negotiation of their status, achieving legitimacy may make companies less, not more, similar.

Source: Kostova, T., Roth, K., & Dacin, T. M. (2008) Institutional theory in the study of multinational corporations: A critique and new directions. *Academy of Management Review* 33(4), 994-1006.

SOCIAL RESPONSIBILITY FOR MNE AS RECOMMENDED BY INTERNATIONAL ORGANIZATIONS

MNEs and Host Governments

- Not interfere in internal political affairs of host countries (OECD, UN)
- Consult government authorities and national employers' and workers' organizations to ensure that their investments conform to the economic and social development policies of the host country (ICC, ILO, OECD, UN)
- Reinvest some profits in the host country (ICC)

MNEs and Laws, Regulations, and Politics

- Respect the right of every country to exercise control over its natural resources (UN)
- Refrain from improper or illegal involvement in local politics (OECD)
- Not pay bribes or render improper benefits to public servants (OECD, UN)

MNEs and Technology Transfer

- Develop and adapt technologies to the needs of host countries (ICC, ILO, OECD)
- Provide reasonable terms and conditions when granting licenses for industrial property rights (ICC, OECD)

MNEs and Environmental Protection

- Respect the host country laws and regulations concerning environmental protection (OECD, UN)
- Supply information concerning the environmental impact of activities to host governments (ICC, UN)

MNEs and Consumer Protection

- Preserve safety and health of consumers by disclosing appropriate information, labeling correctly, and advertising accurately (UN)

MNEs and Employment Practices

- Cooperate with host governments to create jobs in certain locations (ICC)
- Give advance notice of plant closures and mitigate the adverse effects (ICC, OECD)
- Respect the rights for employees to engage in collective bargaining (ILO, OECD)

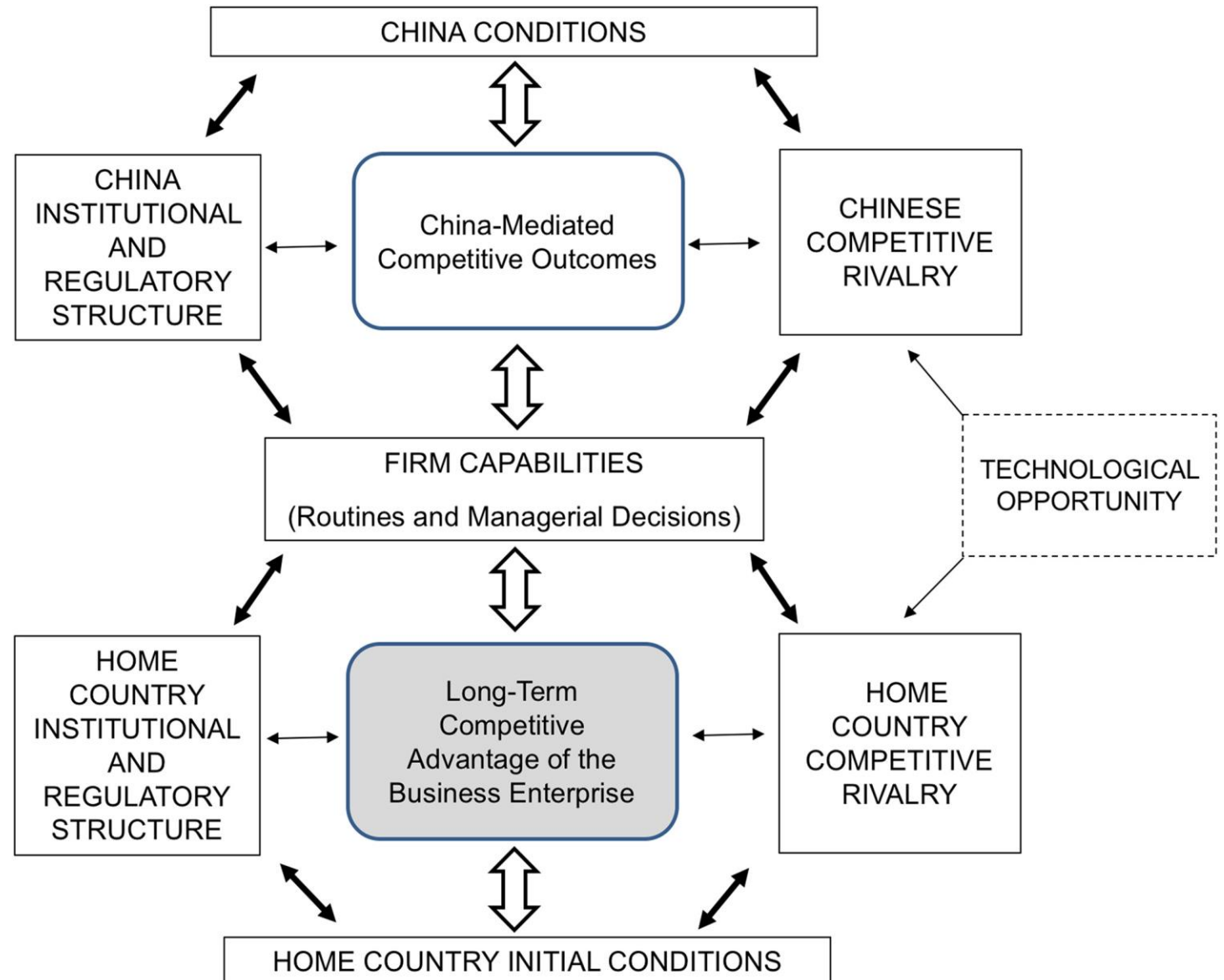
MNEs and Human Rights

- Respect human rights and fundamental freedoms in host countries (UN)

... and also a responsibility for the future of democracy? (D. Teece)

TEECE REVISITED: WIDENING THE LENS TO INCORPORATE THE IMPACT OF A BIFURCATED POLITICAL ECONOMY

“The growth of China and President Xi's policies have transformed the global economy in ways that global strategy and international business (IB) scholars have yet to reflect fully in their research. The global economy is increasingly bifurcated between a China-centered authoritarian system and a market-oriented democratic system, generating complications and perils largely unknown since the end of the Cold War. The global business environment now bears faint resemblance to existing models in IB. To properly analyze the new reality, global strategy and IB scholars need to adopt a wider-aperture, systems-theoretic view that will require the cross-fertilization of ideas and collaboration with other disciplines such as international political economy. This engagement will allow the development of more broadly based frameworks, theories, and models that can assist decision makers in the private and public sectors.”



Source: Teece, D. (2022), A wider-aperture lens for global strategic management: The multinational enterprise in a bifurcated global economy. *Global Strategy Journal* 12(3), pp. 488-519