

## RESEARCH PROSPECTIVES

### TOWARDS A PRACTICE-BASED VIEW OF STRATEGY

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*Many studies in strategic management attempt to explain macro-level firm behaviors or characteristics and/or the influence of such behaviors or characteristics on firm performance. Current strategy scholarship, however, rarely considers specific, actual techniques that managers might use to develop strategies or generally applicable firm practices. We propose a practice-based view (PBV) of strategy scholarship to address this gap. In contrast with the resource-based view emphasis on things that other firms cannot imitate, the PBV examines publicly known, imitable activities, or practices amenable to transfer across firms. We provide evidence for the PBV and discuss its contribution to strategy. The PBV has two important implications, one relating to potential explanations for performance and the other relating to the kinds of prescription strategy that scholars might offer. Copyright © 2014 John Wiley & Sons, Ltd.*

## INTRODUCTION

Many studies in strategic management attempt to explain macro-level firm behaviors or characteristics and/or the influence of such behaviors or characteristics on firm performance. Contrast this approach with the approach in operations research or parts of marketing research. Operations research largely develops techniques intended to help managers. Likewise, much of marketing emphasizes techniques (conjoint analysis, hedonic pricing, etc.) that tie to the specific decisions marketing managers make. Current strategy scholarship, however, rarely considers specific, actual techniques managers might use to develop strategies or

generally applicable firm practices (outside of a few areas such as executive compensation).

We propose a practice-based view (PBV) of strategy scholarship to address this gap. We define a practice as a defined activity or set of activities that a variety of firms might execute. In contrast with the resource-based view (RBV) emphasis on things that other firms cannot imitate, the PBV examines imitable activities or practices, often in the public domain, amenable to transfer across firms.

Our interest in the PBV stems from studies that show that use of publicly known, common practices significantly influences firm performance. While some arguments in the RBV assume that publicly known techniques cannot give firms consistent performance advantages (cf., Barney, 1986, 1991; Peteraf, 1993), many empirical studies, across a variety of domains, find that firms vary in their use of publicly available management practices, and such variation partially explains firm performance

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(Bloom and Van Reenen, 2006; Combs *et al.*, 2006; Nohria, Joyce, and Roberson, 2003).

To provide a taste of the kind of evidence for the PBV, consider a series of studies by Bloom and colleagues (Bloom and Van Reenen, 2006; Bloom *et al.*, 2007, 2012, 2013). These studies examine the association of performance and the use of management practices in very large samples of firms from multiple countries. They consider standard practices such as setting goals, having clear performance measurement, working to attract talented people, rewarding high performance, and removing poor performers. None of these practices is secret or technologically complex, nor do they require some hard-to-transfer resources or capabilities. The results are consistent across studies. Whether measuring performance by sales, return on capital, sales growth, or bankruptcy, the use of standard management practices positively influences firm performance, and the use of such practices differs widely across firms. While U.S. firms in their samples use these management practices more often than firms in other countries, many U.S. firms do not use many of the practices (Bloom *et al.*, 2012).

Perhaps their most compelling evidence comes from an experimental study using a sample of Indian textile plants (Bloom *et al.*, 2013). The study used professional consultants to provide different advice to randomly assigned treatment and control groups of firms. The consultants advised the treatment group in practices such as regular maintenance of machines, recording reasons for machine breakdowns, removing trash from the factory floor, and having an accurate account of raw materials inventory. The control group received less directive advice. The treatment group, encouraged to follow these practices, increased their average productivity by 11 percent compared to firms in the control group, that were given more general advice.

These studies show that firms differ in their use of rather simple and seemingly obvious practices, and these differences lead to performance differences across firms. While Bloom *et al.*'s (2013) experimental study examined particularly simple practices, practices in the PBV are not necessarily simple or obvious; they may be very complex and stretch across a variety of substantive domains (Collins and Clark, 2003; Kaynak, 2003; Vonderembse and Tracey, 1999). Work on technology, for example, examines firm practices dealing with patenting and the geographic location of

facilities (Furman *et al.*, 2006). A massive literature has studied the effective implementation of total quality management and its benefits (Reed, Lemak, and Montgomery, 1996; Winter, 1994). Work on boards and top management deals with a variety of practices in the composition of such groups (for example, diversity of backgrounds or ratio of insiders to outsiders) and in their processes (Carpenter, Geletkanycz, and Sanders, 2004; Rau, 2005; Westphal and Milton, 2000; Westphal and Zajac, 1995; Zona and Zattoni, 2007). Some of the practices in the PBV may deal with strategy formulation and implementation, but others could deal with specific activities that influence performance such as, for example, GE's major management initiatives like the workout process, the emphasis on management selection and development, and stretch goals. Essentially, any practice that provides specific guidelines to managers on how to behave becomes a potential explanation of firm performance variable in the PBV.

Consider, for example, the substantive domain of risk. We choose risk largely because we have worked in the area; our concerns apply equally to our work as to the work of others. Strategy work on risk largely uses management incentives and firm past performance to explain firm-level behaviors associated with risk and the impact of such behaviors on firm performance. Like many strategy areas, however, what we study ties only weakly to the manager's problem. Telling managers that low performance increases their tendency to take bad risks is helpful, but not central to strategic risk management. Managers want to know what to do (i.e., practices), and we have relatively little to tell them.

Similarly, in the area of mergers, we have an immense amount of fine scholarship explaining who undertakes mergers and the performance of such mergers. We might want to understand how companies: (1) identify merger targets using what tools or practices, (2) evaluate targets using what techniques and criteria, (3) decide on mergers by what criteria, and (4) execute mergers. Work on practices in mergers has largely emphasized post-merger integration (e.g., Zollo and Singh, 2004, identify a number of specific tools that banks could use to improve integration) although Haspeslagh and Jemison (1991) consider a broader set of activities. In each issue, we want to understand how variation in activities associates with the success of the activity.

Contrast these streams of research with strategy research on practices in executive compensation. Perhaps because executive compensation is one practice reported in public data, we have an immense set of studies examining the determinants of executive compensation and the influence of executive compensation on firm behavior and performance. Note that this does not mean we end with simple, easy-to-use answers. For example, we may find particular incentives have a variety of impacts, some desirable and some not. However, at least this speaks directly to something managers and boards can do. We have more specific advice for managers and boards regarding compensation than in most other areas.

Note that the PBV can equally deal with practices that reduce performance as with practices that improve performance. A good theoretical understanding of the impact of a practice on performance can apply to both beneficial and harmful practices. If we want to explain variation in performance, knowing what not to do may be quite valuable. Think about coaching someone in a sport. Part of coaching is teaching the athlete what to do, but part is also teaching the athlete what not to do.

We therefore propose the PBV as a means of drawing strategy scholars' attention to management practices and techniques. Focusing on practices will help us to create specific, actionable advice for managers and other practitioners while continuing to advance our ability to explain firm behavior and the influence of firm behavior on performance.

### Contribution of the PBV

The PBV can contribute to a deeper understanding of the determinants of firm performance, but does not simply lead to lists of good things to do. Consider the compensation example we discuss above. The first order effect may be between having particular forms of incentives and not having them (e.g., in general, firms that issue stock options may outperform firms that do not issue stock options). A second order effect, however, rests on how the firm implements those practices. Firms have developed a plethora of variations in the details of executive compensation contracts and behaviors; these variations may cause the same practice to have different effects on performance across firms.

Here, the PBV connects with previous work following the behavioral theory of the firm (BTOF, Cyert and March, 1963) and related work. The

BTOF views the firm as a complex system of routines. The implementation of practices in organizations very frequently involves new or changed routines. If practices align with routines, the benefits of practices should depend on the practices themselves as well as on the parameters and management of the practices. For example, a bank may follow industry standards in creating a practice for approval for loans. However, the impact of that practice on bank performance will depend on specific guidelines and criteria set by the bank. The impact may also depend on the interaction of the practice with others. For example, even the most well-designed risk management practice may have limited impact if the organization has strong incentives for excessive risk taking (Brooks, 2010).

The PBV also connects very strongly with evolutionary economics (Nelson and Winter, 1982; Winter, 1964). Winter (1994) suggests that some practices such as quality management provide a way of eliciting a firm's tacit knowledge embedded in its existing routines, examining these routines to identify opportunities for improvement, and then helping the organization evolve by identifying and selecting new and better routines. This process of elicitation, examination, identification, and selection depends on the firm's history. As with the BTOF, organizational history and context moderates the influence of practices.

The PBV likewise connects to work on capabilities. If we consider a capability the ability of an organization to do something, then capabilities derive from an interaction of routines, learning mechanisms, and choice (Zollo and Winter, 2002). This process of adapting capabilities will also depend on the explicit or implicit choices that firms make about practices. For example, the practice of codifying knowledge from acquisitions will change what and how much the organization learns from acquisitions, eventually resulting in the modification of current practices or routines (Zollo and Winter, 2002).

Another way to understand the contribution of the PBV is in the causal structures investigated. In most strategy research, we have a construct that influences performance. If we see specific practices mentioned, they largely are as indicators of this unobserved construct. Figure 1 presents a path diagram of this process.

The symbols use the standard notation in path analysis, i.e., the rectangular or square boxes signify observed or manifest variables, and the ellipses

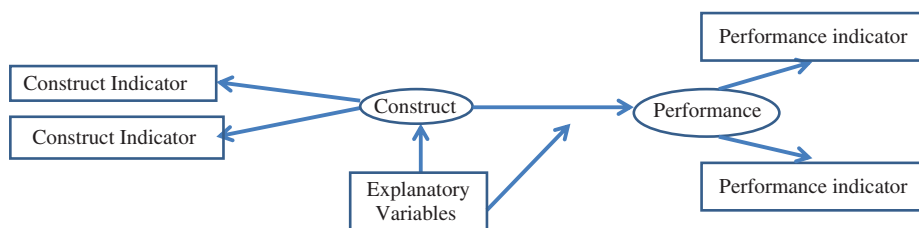


Figure 1. Traditional model of strategy research

signify unobserved or latent variables. The straight arrows signify that the variable at the base of the arrow “causes” the variable at the head of the arrow (Bollen, 1989). For example, if the construct of interest were diversification, we might use effect or “reflective” indicators (i.e., indicators caused by the construct, like the entropy measure of product diversification and the entropy measure of geographic diversification) to measure the unobserved construct of diversification (Bollen, 1989). Modelers attempt to explain diversification by firm variables like size, experience in previous diversification, governance, etc. (For the sake of simplicity, we have represented these explanatory variables as manifest variables in Figure 1). The theories that strategy scholars normally test deal with the determinants of the construct and the influence of the construct on firm performance. If it were risk, we might use variance in analyst forecasts or beta as risk indicators and attempt to explain risk by factors like previous firm performance and management incentives. Often, we use a single indicator for a construct. In general, our theories deal with the variables that explain the construct (e.g., diversification or risk), the impact of the construct on performance, and the variables that may modify the impact of the construct on performance. Because we often use a single indicator for a construct, strategy scholars are often not explicit about the indicator-construct relation.

In contrast, a practice orientation would examine the impact of the practice itself.

As shown in Figure 2, here the practices are important entities in and of themselves rather than simply indicators for some underlying construct. In some cases, scholars might try to relate the practices directly to performance and in others they might operate through an intermediary construct. The full toolbox of moderated and mediated effects can apply in a practice approach just as they can in the standard approach.

To illustrate, in the risk context, we might consider firm risk-management practices, for example, whether the firm uses enterprise risk management (ERM) or value at risk (VaR) (see, for instance, Anderson & Schröder, 2010). We may want to explain which firms use which practices and so have explanatory variables influencing use of the practices. We might argue that the practices influence a performance outcome of interest and that their influence depends on some other factors. For example, we might hypothesize that large firms use ERM more than small firms and that size moderates the influence of ERM on firm risk.

This minimal model could easily be expanded in a variety of ways. For example, we might hypothesize that some unobserved construct mediates the influence of the practices. In the risk example, the practices might influence risk and risk influence performance (see Figure 3).

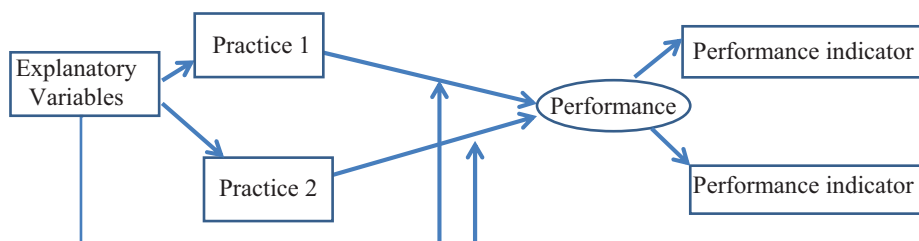


Figure 2. PBV model of strategy research

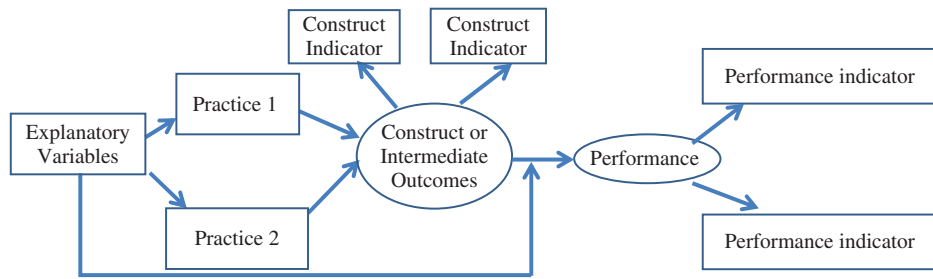


Figure 3. Expanded model of PBV approach to strategy research

The important distinction here is that the use of practices becomes a central part of the theory and modeling. Instead of using ERM or VaR usage as indicators of good risk management, we focus directly on their use.

Understanding practices requires both qualitative and quantitative analysis. The strategy-as-practice movement adds important qualitative information on firm processes (Carter, Clegg, and Kornberger, 2008; Jarzabkowski, 2004) as does an older tradition in strategy process (see, for instance, Bower, 1970, and Bromiley, 1986). However, strictly qualitative research has a limited ability to identify effective processes rigorously. The PBV includes the qualitative work in strategy-as-practice, but adds the need for quantitative work as well. We mentioned some examples of this work during our earlier discussion. Research on replication of practices (Szulanski and Jensen, 2006), acquisitions (Zollo and Singh, 2004), and alliances (Kale and Singh, 2007; Kale, Singh, and Perlmutter, 2000) provide additional examples. Szulanski and Jensen (2006), for instance, examine the relation between the number of steps that were followed in a 52-week plan and the number of franchisees added each year in Mail Boxes Etc.'s international network, over a number of years. Kale and Singh (2007) use large sample survey data to examine how an alliance function leads to learning (as captured by articulation, codification, sharing, and internalization), which in turn influences alliance success.

In almost all cases, to judge the relative effectiveness of practices requires data where use of the practices and performance vary. To estimate the relations between practice and outcome with any reliability, the sample must be substantially larger than the number of practices examined. Eventually, we will probably have to: (1) engage in the identification of practices in specific areas, (2) use survey

or similar methodologies to assess firm use of practices, and (3) assess the effectiveness of different practices. Given the emphasis on actual firm practices, the PBV offers an excellent mechanism to implement more engaged scholarship (Van de Ven, 2007). Identifying firm practices is an ideal domain for engaged scholarship, and assessing the effectiveness of practices offers the kind of output that practitioners will find valuable.

### How the PBV differs from the RBV

Given their common emphasis on firm activities, the PBV and RBV share some apparent similarities. However, the PBV differs from the RBV in two ways: definition of the dependent variable and isolating mechanisms.

#### Dependent variable

We think that PBV research should focus on firm or business unit performance as the dependent variable. This is in contrast to seminal RBV articles such as Barney (1991) or Peteraf (1993), which explicitly state that the purpose of the RBV is to explain how some firms gain sustained competitive advantage. Indeed, “sustained competitive advantage” appears in the title of Barney (1991) and the abstract of Peteraf (1993). If one cites Barney (1991) or Peteraf (1993) as the theoretical foundation for the RBV, the main aim of the RBV is to explain sustained competitive advantage.

One reviewer questioned why we did not see sustained competitive advantage or sustained relative advantage as the appropriate dependent variable for the PBV. We think PBV research should focus on firm performance rather than advantage for several reasons.



First, we know of few papers that actually implement the “sustained” and “advantage” parts of sustained competitive advantage (Bromiley, 2005). To test a theory that attempts to explain the difference between firms with sustained competitive advantage and other firms requires a dependent variable that categorizes firms as having or not having sustained competitive advantage. Almost all empirical papers claiming a relation to the RBV use conventional performance measures like return on assets (ROA) or Tobin’s Q. Empirical results with such measures could just as easily reflect the model distinguishing between below-average performance and average performance as between average and above-average performance (which appears associated with competitive advantage). Furthermore, annual or quarterly performance measures completely ignore the “sustained” part of the construct.<sup>1</sup>

Second, if one measures advantage solely by performance, then advantage is superfluous. Measuring advantage by a single indicator of performance relinquishes the ability to differentiate empirically between performance and advantage. If we do not empirically distinguish between advantage and performance, then Occam’s Razor suggests one of the two concepts should be avoided. Observable indicators of firm performance (ROA, Tobin’s Q, and similar measures) are clearly more valid indicators of firm performance construct than competitive advantage.

Performance has a third benefit in that it has tangible meaning in both academic and practitioner communities. It communicates more clearly than advantage. In short, for these reasons, we think PBV scholars should emphasize performance rather than advantage as their dependent variable.

### *Isolating mechanisms*

The second major distinction between the RBV and PBV stems from the idea that “sustained” competitive advantage requires isolating mechanisms. This need for isolating mechanisms underlies various parts of the RBV as presented by Barney (1991) and

Peteraf (1993). The RBV requires that managers not fully understand how to create their resources to prevent the manager selling that knowledge to other companies. It requires that resources not be subject to imitation. Indeed, the arguments in Barney (1991) and Peteraf (1993) claim that publicly known, imitable practices cannot lead to sustained competitive advantage.

The PBV generally applies to practices that have weak or nonexistent isolating mechanisms. The studies noted above demonstrate that firm use of these kinds of standard, publicly available practices explain substantial performance variation. How long a given practice will explain performance variation (i.e., how long it leads to “sustained” advantage) is itself a worthy topic for research, but the indications are that use of practices can confer benefits for substantial durations. Combs *et al.* (2006) finds personnel practices like incentive compensation, training, and performance appraisal associate with high performance; these practices have been standard in the personnel texts and books for decades. Bloom and Van Reenen (2006) find that tracking production performance explicitly, managerial performance having consequence for the managers, rewarding high performers, removing poor performers, and formal performance reviews, among other factors, associate with high performance. Thus, it appears use of practices not protected by isolating mechanisms can provide enduring performance benefits. The PBV is largely concerned with practices that can be transferred across firms, i.e., that are not protected by extremely strong isolating mechanisms.

### **Additional implications of the PBV for strategy scholarship**

In addition to its potential for creating research that is more relevant to practitioners, the PBV has some important implications for strategy scholarship itself. We identify two—the potential explanations for performance and the potential for prescription.

The PBV increases the legitimate potential explanations for performance variation. Specifically, in addition to RBV resources, the PBV adds the use of the plethora of practices in the public domain. In the PBV, firm performance should depend on: (1) the use of specific practices, (2) the details of how those practices are used, (3) the interaction of those practices with other practices in the firm, and

<sup>1</sup> We suspect that the emphasis on advantage rather than performance comes from a concern that firms might choose lower current performance to maintain higher long-term performance (e.g., by a monopolist keeping prices below the optimum to deter entry). However, this can be handled by talking about time tradeoffs in performance as easily as talking about competitive advantage. Indeed, the original theory papers in the pricing-to-deter-entry literature dealt with performance not advantage.

(4) the behavior of competitors. Behavior of competitors enters here since the benefits of a practice are often relative. For example, in an industry that does not emphasize marketing, a firm might gain from having modest marketing skills whereas in a marketing-intensive industry, that would not suffice.

Finally, the PBV has implications for the kind of prescriptions that strategy scholars might offer. The PBV could offer publicly available techniques as prescriptions, with the caveat that strategy scholars should try to identify when and under what conditions the use of specific techniques have the most value. By focusing on practices, the PBV will naturally lead to direct recommendations of things managers can do.

The PBV offers a new and different perspective on strategy scholarship complementing extant views like industry analysis, RBV, and the knowledge-based view. The PBV opens new topics for research, and has the potential to change how scholars view variations in firm performance, what variables they use to explain performance, and what they prescribe for firms.

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