Discourse Between Strategy Formation and Implementation: A Globalized Social Capital Perspective

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ABSTRACT

Due to the prevalence of cost-leadership for competitive advantage among U.S. firms and accompanying consumer expectations suppressing prices, strategic migration has become stylish. Firms have moved operations such as production, service support, and R&D outside of their traditional domestic environments in order to lower costs, particularly on human capital, in an attempt to sustain cost-based competitive advantage. This widespread strategic move has occurred throughout industries from manufacturing to services, including computer hardware, automobiles, textiles, medical equipment, telecommunication services, and even agriculture. When exploring the rapid shift from U.S. domestic to global operations in the hunt for cost-based competitive advantage, it is apparent that Porter's (1990) Complete System Model does not adequately consider the humanistic/social factors that are essential to the sustainability of most, if not all forms of competitive advantage. This paper looks beyond Porter's Complete System Model to theoretically examine the importance of social capital in a network of globalized transactions and its importance, yet overlooked role in the sustainability of cost-based competitive advantage.

INTRODUCTION

In global strategy research, the question of what constitutes a successful merger, acquisition, strategic alliance, or foreign direct investment has received great attention. The strategic search for competitive advantage entails different approaches for planning and implementation. Porter (1980) describes competitive strategy as taking either offensive or defensive actions towards creating a more defendable position in its industry. The Five Forces Model (1980) and the Complete System Model (1990) were developed by Porter and he identified three types of

generic strategies firms may choose to further their unique goals. The first is cost leadership, the second is differentiation, and the third is the focus strategy (Porter, 1985). In this paper, cost leadership strategy will be the primary theme in the discussion.

Labor intensive industries often seek cost competitiveness by moving operations offshore, but no matter which type of strategy is formulated, it is important to create a strategic discourse between formation and implementation. Such an integrative and episodic approach has been advocated by Mintzberg (1990), as detailed after his nine schools or typologies of strategy. For example, one should consider the type of organization, kinds of environments, and distinct periods of history and life cycles. For researchers developing a theory, it is important to consider the praxis of the theory. Praxis examines how practice informs theory and theory informs practice and the interaction between the two contributes to social change or transformation (Armstrong, 2002).

Porter (1990) developed a competitive strategic model at the industry level that he calls the Complete System Model. This model introduces important elements and relationships that influence the decision-making of competitive strategies within an industry. Porter's (1990) strategy foundation and modeling is from a macro perspective and his framework is structured within the first cybernetic system in which the equilibrium position is not merely determined by the equations of the system, but the system will move to the maintenance of the given equilibrium (Boulding, 1956). As Argyris and Schön (1978) state that to move from single loop to double loop learning, we must think critically and question our underlying assumptions about reality. As firms move offshore, they must accept and adapt to a different reality than they are used to, especially in the forms of social capital. Organizations, operated by humans, do not always know who they are and what they can and cannot do. Weick (1995, 133-134) states that "Organizations are presumed to talk to themselves over and over to find out what they are thinking." Such reflexive elements are lacking in Porter's macro view. Therefore, many firms fail when first venturing abroad because they do not have full knowledge of the scope of the new environment where they entered.

Trust and relational network capital, aspects of social capital and transaction cost theory (Coase, 1952; Williamson, 1991; Putnam, 2000), are two very important elements for strategy implementation and business success. Transaction cost theory is a micro level strategic approach, while the social capital concept has been frequently addressed in sociology research. Recently, the social capital has gained prominence in the field of management studies, but most discussion has addressed social capital as both a macro and micro level concept, depending on the decision maker's position or level.

Porter's (1990) macro Complete System Model addressed the following elements:

- Human resources – measured by quantity, skills, cost of personnel, and work hours;
- Physical resources – quality, accessibility and cost of land, water, mineral, or other physical traits;
- Knowledge resources – scientific, technical, and market knowledge of goods or services produced;
- Capital resources – cost of capital available to finance industry;

- Infrastructure – type, quality and cost of infrastructure available that relate to the competition.

Social capital is different from any of the resources mentioned in Porter's model, but they are closely linked. Although social capital is allowed in Porter's model, it fails to be adequately recognized by practitioners. Implementation of strategy commonly takes place at the micro level. While introducing a macro strategic theoretical model, Porter included some micro level factors (e.g. trust, labor hours, pay rate, network, knowledge); however, how these factors were to be understood in practice and further operationalized was not entirely clear. This leads to a disconnect between theory and practice, as the theory does not fully specify the implement-ability (praxis) of the social factors involved. The purpose of this paper is to theoretically examine the importance of social capital in relation to sustainability of cost-based competitive advantage.

GENERAL STRATEGY – PORTER'S MODEL

Cost leadership strategy, one of Porter's (1980) three competitive strategies, calls for a firm to be the low cost producer in the industry for a certain level of quality. The ability to sustain such advantage comes from improving process efficiencies, gaining exclusive access to large sources of low-cost materials, making the most beneficial outsourcing selection decisions, or even from avoiding certain high end costs like human labor.

After developing the Five Competitive Forces Model (Porter, 1985), Porter realized that industry dynamics were changing, therefore, the parameters and relationships present in his model were no longer adequate. Regionalization of operations, diversification, and globalization have become the main trends in the new business environment and Porter (1990), theorized the Complete System Model to symbolize the new business competitive environment.

Porter (1990) answers the question of how firms can achieve global success in one particular industry by introducing four broad attributes to shape the environment. These determinants of competitive advantage include the following:

- *Factor Conditions* – contains the firm's position of factors of production or design that are necessary to compete in a given industry. The firm's richness of factors plays an important role in competitive advantage, like human resources, physical resources, knowledge resources, capital resources, infrastructure mentioned previously. When a company obtains low-cost or uniquely high-quality mix of these factors, the firm can compete better in a particular industry.
- *Demand Conditions* – explains the domestic demand for the industry's product or service. The quality of domestic demand is much more important than the quantity of domestic demand in determining competitive advantage (Porter, 1990). Understanding and responding to needs in a timely and sufficiently manner would support a firm's competitive advantage.
- *Related and Supporting Industries* – describes the suppliers or related firms international competitive advantage position. Some supplier industries produce inputs that are widely

used and important to innovation or to internationalization. The internationally competitive supplier industries create competitive advantage for the firm.

- *Firm Strategy, Structure, and Rivalry* – the conditions in the firm that govern how the company is created, organized, and managed and the nature of domestic rivalry. Porter (1990) describes that no one managerial system is universally appropriate. To be competitive, individual goals and company goals need to be aligned; individual commitment, management commitment, and organization commitment need to be on the same page.

These determinants interact and influence each other, thereby creating a system, a context in which firms are born, compete, and live and die. Two additional factors, *Chance* and *Government*, can also influence the whole system (Porter, 1990). Chance events develop outside the control of firms and can reshape industry structure or activities, perhaps in unpredictable ways. Chance events are occurrences that have little or no relation to circumstances within the firm and are often outside the power or influence of the firm. According to Porter, although chance events are not within the control of firms, they are important because they create discontinuities that allow shifts in competitive positions. Chance events have unsystematic impact on different firms (Porter, 1990).

Government, as an element in the model, can either benefit or destroy the firm's competitive advantage. It also interacts with other factors and no successful business can do without a sufficient understanding of governmental policy and good relations with the government. Unlike Chance, in Porter's model, Government has a two-way influential relationship with the four main system elements.

In this section, we explored Porter's Complete System Model of competitive strategy, its assumptions and configurations. In the next section, we will introduce the concept of social capital and we will discuss why social capital should be considered an important element in strategy formation and implementation.

SOCIAL CAPITAL

Social capital is a socio-economic concept with a variety of interrelated definitions based on the value of the social networks. The concept of social capital can be traced back to sociologist Jane Jacobs in the 1960s, but it was little used even in sociology until it was adopted by Pierre Bourdieu in the 1980s. After that, the concept got picked up by James Coleman and others. In the 1990s, from an individual perspective, Ostrom (1994) introduced social capital as the arrangement of human resources to improve flows of future income; Meyerson (1994) described social capital as the array of valuable relationships a person has accumulated over time; and Stanton-Salazar & Dornbusch (1995) discussed social capital as social relationships from which an individual is potentially able to derive various types of institutional resources and support. From a collective perspective, Putterman (1995) described social capital as a form of cultural capital: a stock of knowledge, behavioral repertoire, and attitudes that are held by their members as collectivities, with certain classes of individuals specializing in some parts of this stock, other classes in other parts; and Fukuyama (1997) said that social capital can be defined simply as the existence of a certain set of informal values or norms shared among members of a group that

permit cooperation among them. In the 2000s, the concept became highly fashionable and achieved public awareness through Robert Putnam's 2000 book, *Bowling Alone*.

Social capital involves the connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them (Putnam, 1996; Adler & Kwon, 2002). When investors enter a new nation, even with extensive research, there will always be some unknown factors that contribute to uncertainty and higher risk (Haley, 2003). Often, such risk is related to the lack of understanding and satisfaction of social capital in the new environment, a potentially costly mistake.

Pierre Bourdieu (1983) observed that capital is categorized into three basic types: economic – directly convertible to money; cultural – convertible with conditions into monetary aspects, it is of the mind and body; and social – made up of social connections and is convertible with conditions into monetary aspects within the present and possible networks. All forms of capital influence and counter influence each other. Bourdieu (1983) defined social capital as, "the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance and recognition." Within social networks, Granovetter (1983) described weak ties as often likely to interact compared to strong ties like friends. Putnam (2000) defined social capital as "the collective value of all 'social network' and the inclinations that arise from these networks to do things for each other," where social capital is considered a key component to building and maintaining democracy and peace.

Social capital is an intangible concept that can be converted to tangibles, but of course with difficulty. At the societal level, Coleman (1988) expressed that there are three forms of social capital: obligations, trustworthiness, and expectations; information channels; and social norms. These social capitals connect people and maintain social networks. Coleman's (1988) research defined social capital by its functions. There is no single entity but a variety of different entities with two elements in common. All elements consist of some aspect of social structure, and they facilitate certain actions of actors within the structure. Social capital inheres in the structure of relations between actors and among actors. Social capital comes about through the changes in relationships among individuals and it facilitates these relationships. Social capital is a paralleling concept of financial capital, human capital and physical capital (Coleman, 1988).

Transformation is implicit and brings opportunities and danger (Coleman, 1988). The future is in the design of organizations, institutions, and social environments. Design is intended for optimal outcomes, like the emphasis of Porter's theory on optimization. The process should be a rational process in which reconstruction of society takes place. However, what should be a rational process in theory is often far less so in practice. For instance, social capital facilitates inter-unit and exter-unit/supplier resource exchange, innovation, and strengthens firm supplier relationships (Gabbay & Zucherman, 1998), but individuals are assumed to be opportunistic when entering any type of transaction (Coase, 1952; Williamson, 1991). Building upon Adler and Kwon's (2002) theory, Weisinger and Saipante (2005) found that in a group setting, even when sufficient opportunity and mission-based motivations exists, bridging social capital will likely be insufficient to sustain interactions among diverse members. With some understanding of the importance of social capital in organizations, in the next section we will turn to integrating this concept with competitive advantage.

DISCUSSION

Cost leadership competitive advantage strategy has resulted in greater complexity and interdependence in operations and resources. This leads to challenges for firms to manage not only domestic but also globalized social capital. It is important to realize that a firm's growth is directly linked with societal values and intrinsic attitudes (Loza, 2004).

Globalization can be viewed as a process firms follow either to seek greater markets or to seek low-cost strategic leadership to gain competitive advantage. After a firm globalizes its operations, localization must take place in order to gain local social capital to sustain the success of the firm. Deleuze and Guattari (1987) introduced three concepts – teerritorialization, deterritorialization, and reterritorialization – which Hardt and Negri (2000) applied to globalization. They described the globalization process as the deterritorialization of the already built territories upon which western theory and philosophy blindly imposed other cultures' values and systems. This imposition cannot be a long-term solution for a firm if a long-term strategic investment is in place. The process of localization must take place and this is what Deleuze and Guattari (1987) called the reterritorialization process. The localization of operations needs to consider the social relations and social networks within the new business environment. Political institutions and the embedded autonomy of political actions can positively influence social capital in the local economic development (Trigilia, 2001) which was weakly addressed in Porter's macro Complete System Model.

It is important to recognize the human aspects of production and profit (Chakraborty et al., 2004). Corporate social responsibility and societal good citizenship should be one of the main concerns for organizations. In order to be a successful leader of a globalized firm, firms need to learn valuable political skills and gain political capital within the nations in which they operate (Harvey and Novicevic, 2004). Understanding the history of the culture, the people, relationships, and values are more important than formal western systems and theories (Sporer, 2004).

Ireland et al (2002) found that strategic alliances help firms gain resources and knowledge which lead to competitive advantage. To maximize cooperation among all partners, trust must be developed and value created through such an alliance. This process builds social capital and is essential for firms when accumulating financial capital (Florin et al, 2003). It can provide firms with durable and accountable sources of competitive advantage. Trust can become more important than the law and regulations. With trust and these collective phenomena in place, Schuurman (2003) describes social capital as the contours of the anti-politic machines. Adequate social capital building and maintenance will help the firm to reduce the risk in doing business in the global market.

In strategy literature, much has been written on planning, but very little on implementation and almost nothing on the links between the two processes. Planning is no doubt a very important step in strategy decision-making, but most plans fail in the implementation phase. Most strategists focus on the economic/industrial aspects of operations but miss the social aspects at

both planning and implementation phases. To better manage cooperation activities, it is important to first create common ground among individuals and manage social capital to provide competitive advantage (Chung and Gibbons, 1997).

The boundary of domestic competition is no longer clearly defined within the domestic environment. As business operations reach beyond the U.S., the implications of the relationships between appropriate strategy formation and implementation in a broadened environment become even more critical. It is impossible for firms to obtain detailed knowledge for every problem due to a increase in complexity and a rapidly changing context. For the sustainability of competitive advantage in the global environment, factors come into play such as communication, language, customs, information exchange methods, rituals, and other social attributes. No matter what strategies firms choose to utilize, people are the core source of competitive sustainability (Rastogi, 2000). Human capital in the form of skills, knowledge, expertise, creativity, and innovation feeds into social capital and can enhance a firm's competitive advantage.

Porter's theoretical position is based on a macro strategic view and an understanding of the behaviors of the industry economic environment as a whole is essential. The model tends to be rational because it is based on the assumption that information is transparent and that control of information and other resources leads to success. A macro view is definitely important in strategy planning, but strategy implementation involves linking the macro to the micro, the grand narrative to the individual actors and behaviors. Discourse between the two levels is essential.

Porter's Complete System Model is a mechanistic model and does not adequately address the implement-ability (praxis) of the humanistic elements of interactions and relations. A model that informs practice must present micro level details for implementation purposes. From a narrative perspective, Barry and Elmes (1997) describe Porter's theory as a purist narrative strategy, which implies that the model is atemporal. Although Porter's Complete System Model includes several human related factor conditions, the suggested measures for all of these resource-oriented factors indicate that the quantity being measured is not exactly social capital. However, social capital, like social relations and networks, is at an early stage of research and many of the phenomena cannot yet be adequately described and measured.

CONCLUSION

In this paper, Porter's Complete System Model was discussed and a literature review was offered in the area of social capital and globalized competition. The importance of social capital in relation to competitive sustainability was explored and Porter's model was found lacking in the humanistic aspects necessary for success in long-term global investments. In particular, it can be shown that an adequate understanding, establishment, and maintenance of social capital in a global environment can lessen uncertainty and risk, factors that Porter relegates to a black box labeled *Chance* beyond the control of all firms.

Porter's model of competition has played such a dominant role in strategic research over the past two decades that few have questioned or called attention to its inadequacy. The concept of social capital can assist in filing the gap in our understanding of strategy formation and implementation.

Social capital is addressed under both strategy formation and strategy implementation and should therefore be part of the missing discourse for a reflexive strategy process.

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