

# Institution based view of business strategy | case study



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An industry-based view, illustrated by Porter (1980), decides firm strategy and performance. Sustainable competitive advantages can be discovered by industry analysis and by selecting from the generic strategies. The competitive strength and the firm's ability can maintain positional advantages through the efficient and effective implementation of competitive strategy. (Morgan et al, 2004)

Secondly, a resource-based view (RBV), was demonstrated by Barney (1991), advocates that firm-specific differences determine strategy and performance. RBV emphasizes internal resources and capabilities of organisations (Peng et al, 2009). RBV portrays companies as idiosyncratic bundles of resources and capabilities that are available for distribution by the organization's business units. Heterogeneity in the resources and capabilities is the reason of variations in organization performance. Sustainable competitive advantage is not the result of correct position in the external environment but is derived from the organization's internal resources, which are valuable, inimitable, rare, and nonsubstitutable.

Industry-based view and resource-based view are complementary because they settle the relationship between a organization's resources and capabilities and its positional advantage by arranging how resources and capabilities are coordinated with market situations, the suitability of planned resource and capability and the quality of strategy implementation. (Morgan et al, 2004)

Emerging economies' institutions are largely different from those in developed economies. Formal and informal institutions are commonly

recognized as the "rules of the game" that importantly outline the strategy and performance of both domestic and foreign firms in these economies.

(Peng et al, 2008).

Institution is the humanly created constraints that structure human interaction (Peng et al, 2009). It is regulative, normative, and cognitive structures and activities that provide meaningful and stable social behaviour (Scott, 1995). Institutions can be generally classified as formal and informal. Institutions rule societal issues in the areas of politics (e. g., corruption, transparency), law (e. g., economic liberalization, regulatory regime), and society (e. g., ethical norms, attitudes toward entrepreneurship). The culture can be viewed as a part of informal institutions in the environment that support formal institutions (Redding, 2005).

Formal institutions (such as laws and regulations) and informal institutions (such as norms and cognitions) have long been presumed as background. However, Institution-based view is important for better understand the growth of emerging economies by investigation the complicated and fast changing relationships between organizations and institutions. (Pang et al, 2008) Institution-based view help internationalizing emerging economies companies to improve their competitiveness, knowledge of the game rules of abroad.

In short, the industry-based view does not pay sufficient attention to contexts. Likewise, the resource-based view has been criticized for its little exertion to establish suitable contexts (Priem & Butler, 2001). Barney (2001, p. 52) admitted the value of a firm's resources must be understood in the

particular market context within which an organisation is running. The frustration has called for the new perspective that can conquer these problems. The result is the rise of the institution-based view (Peng et al., 2008).

An institution-based view focuses on the dynamic relations of institutions and organizations, and considers strategic choices as the result of such an interaction (Peng et al, 2009). Strategic choices are not only determined by industry situations and company capabilities, but also the formal and informal constraints of a particular institutional situation. (Jarzabkowski, 2008) Therefore, IB strategy cannot just focus on industry conditions and capabilities. An institution-based view, in combination with the industry- and resource-based views, thus puts the strategy tripod on firmer ground. Institutions are much more than background conditions and it determines the formulation and implementation of strategy and creation of competitive advantage.

Emerging economies is tended to have more essential and integrated changes to the formal and informal rules of the game which are regarded as "institutional transitions" (Peng et al, 2009). There are two core propositions emerging out of the institution-based view to reduce uncertainty in emerging market (Peng et al, 2008). The first proposition is that managers and companies rationally hunt for what they interest and make strategic choices within the formal and informal institutional situation. The second one is while formal and informal institutions combine to rule the organisation behaviour, if formal constraints are ambiguous or failed, informal institution will play a larger role in reducing uncertainty by providing guidance and

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legitimacy. For example, the institution-based view suggests that if a firm cannot be a cost or a differentiation leader in the markets, it can still overcome the competitors in nonmarket political area where informal relationships has large influence. (Oliver & Holzinger, 2008)

There are three important questions in strategy that institution-based view brings new views beyond the perspectives of the industry-based and resource-based views. (Peng et al, 2009) The first question is why do firms differ? A major assumption in strategy, especially from the resource-based view, is firm heterogeneity. (Barney, 1991)

It is long recognized that economic growth can hardly happen in ill-regulated economies. However, given China's strong economic growth and its underdeveloped formal institutional structures, there is always a question that how can Chinese economy become fast growth with such an institutional situation. An answer suggests that interpersonal networks (known as guanxi) which are used by managers may serve as informal substitutes for formal institutional support (Peng & Heath, 1996). In other words, interpersonal relationships among managers are considered as an interfirm strategy of networks and alliances to grow the company that support to the growth of the economy (Peng & Luo, 2000).

There is a prevalent belief that guanxi and the related network-based strategies are commodities of the unique Chinese culture that favours collectivism (Peng et al, 2009). The use of informal networks during institutional transitions is mentioned in the second proposition, which stresses the stronger dependence on informal constraints to handle potential

opportunism and transactions when formal market-supporting institutions are immature. From the first proposition, managers and organizations act rationally under these circumstances. In institutional situations, industry-based and resource-based views alone will not provide a strong reason of the differences between firms (Khanna & Yafeh, 2007). Overall, in situations that formal institutions are weak, informal institutions, such as norms ruling interpersonal relationships, will play a larger role in organisation strategies and performance (Peng & Heath, 1996).

It is important to note that foreign entrants have also positively facilitated their network and relationships when going global, as shown by the abundant international strategic alliances with local organizations (Peng et al, 2009). For example, the UK retailer Boots opened a new shop in Japan. Although the Japanese market has opened to foreign company in recent years, the regulation, cultural norms and arcane business practices are still difficult for foreign firms. By being successful in adapting its style of retailing to the Japanese market, Boots found the best way to overcome the barriers that all foreigners face by adopting the strategy tripod. (Financial Times, 2000)

As mentioned, strategic choices are not only driven by industry situations and firm capabilities, but also the formal and informal constraints of a particular institutional framework.

For example, the company has reformulated more than 2, 000 of its products to gain a Japanese licence, despite they meet the UK and US standards. Also,

Boots has redesigned the packaging of its products to meet the Japanese preference and culture.

Institution-based view helps to understand the impact of institutional transition (Peng, 2003). For example, at the beginning, Boots was unable to bring many of its products to Japan due to its regulations. Yet, the situations changed and there are new regulations that ease restrictions on imports of ingredients used in cosmetics. This helped in the formulation process and logistics process of Boots.

Besides, Boots has realised the special rule of the game in Japan. The “ buy two, get one free” campaign were failed in Japan. It is because many of its customers are single or have small families and they do not need to buy a large amount of products.

Furthermore, to solve the regulation, cultural norms and arcane difficulties, Boots has adopted the institution based strategy to gain local support. It therefore formed joint venture with Mitsubishi. It is a good solution for complicated government contacts because Boots is dealing with logistics, contacts in the legal profession, healthcare professionals and advice on localising the business are very important for Boots.

Apart from the institution-based view, Boots has adopted another two legs of views to compete in the market such as the introduction of seating at its cosmetics counters and this is an usual arrangement in Japanese stores.

Besides, it has changed the packaging of its products to meet the Japanese preference for lavish presentation and the concept of “ lipstick amnesties” that customers return old lipstick and get a free replacement.

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Even though the industry-based view is important for gaining the economy of scale and competing the rivalries by competitive advantage, and resource-based view is important for identifying the firms potential key resources and product differentiation, but organizations like Boots still actively seek to make use of the ‘ rules of the game’. In terms of benefits, an institution-based view can help firms like Boots in emerging economies improve their competitiveness. Boots is necessary to know more about the rules of the game abroad that may be different from the familiar rules at home.

Therefore, it is natural to expect firms in emerging economies (including some foreign entrants) to perform similarly (Lewin & Kim, 2004).

The second question is how do firms behave? The industry-based view suggests that the strategic task is primarily to remove a position that is vulnerable according to the five forces within an industry. The resource-based view uses capabilities to differentiate successful firms from failing ones. The institution-based view adds by arguing that except industry- and firm-level conditions, organizations also need to consider the effect of formal and informal rules of the game.

Most research on entry barriers has focused on market-based variables such as economies of scale and product differentiation, but not nonmarket-based, institutional variables such as antidumping laws which are clearly considered as entry barriers in IB. The industry-based view, based on Porter’s five forces, rarely consider questions behind such rivalry. In international trade, the hunt of a cost leadership strategy that neglects host country trading laws and regulations can simply cause legal action such as antidumping (Peng et al, 2009)

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Foreign firms are often discriminated by the formal rules of the game in many countries (Peng et al, 2009). Discrimination is also obvious in the case of antidumping. Overall, when industry- and resource-based views fail, there is a strong implication for domestic organizations under competitive pressures to use an institution-based view by filling an antidumping petition to organisations which are selling below cost and planning to raise prices after eliminating domestic organisations. (Schuler et al., 2002). The IB strategy , concerning foreign market entry, needs to keep an eye on antidumping as entry barriers and institution-based view pays large attention to the strategic topic of antidumping.

Besides, grey markets are defined as legal importation of genuine products into a country by grey marketers as they buy products cheaper in countries and sell it in another at higher prices. The grey marketer has to be careful as grey market is not legal in every country as it is banned in EU as retailers cannot sell products without the consent of trademark owners. UK supermarket leader Tesco has lost its legal combat for the right to sell cut price Levi's jeans in a case which has implications for trade mark owners and retailers operating in the grey market. Tesco bought jeans from wholesalers in the US and Canada where jeans are sold more cheaply. The jeans were sold in the UK at about half the price suggested by Levi's. (BBC, 2002) In short, company should not just keep an eye on industry based view and resource based view only but institution-based view as doing business needs strong knowledge about the formal and informal rules governing competition in various countries.

What determines the success and failure of firms around the globe is the third question. From the cases above, it is obvious that it is difficult to imagine firms that do not know the rules of the game in a particular country will become winners. In general, an institution-based view suggests that the success and failure of firms around the world, at least in part, are allowed and constrained by the different rules of the game (Peng et al., 2008) The institution-based view has added meaningfully new insights to three questions above.

Overall, the institution based view complements the industry-based and resource-based views to collectively sustain a strategy tripod. Industry position, resource and capability, and institutions all affect organisation strategy and performance. The institution-based view suggests that foreign entrants need to develop a strong knowledge of the rules of the game, both formal and informal in host countries. The industry-based view suggests that the degree of competitiveness in an industry determines organisation performance. The resource-based view suggests that firm-specific capabilities determine performance differences. The institution-based view argues that institutional forces also provide an influence to differences in firm performance because of its significant effects on exporters' strategy and performance beyond the impact of firm competencies and industry factors. An institution-based view of IB strategy in combination with industry and resource-based views do not only help sustain a strategy tripod, but also provide significant new perspectives of international business that what determines organizations strategy in IB and What determines the international success and failure of organizations.