

# Presentation

## Theoretical Frameworks for Addressing Strategic Real Options

**Prof. Dr. Jörg Freiling,  
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Bremen, 18 October 2012

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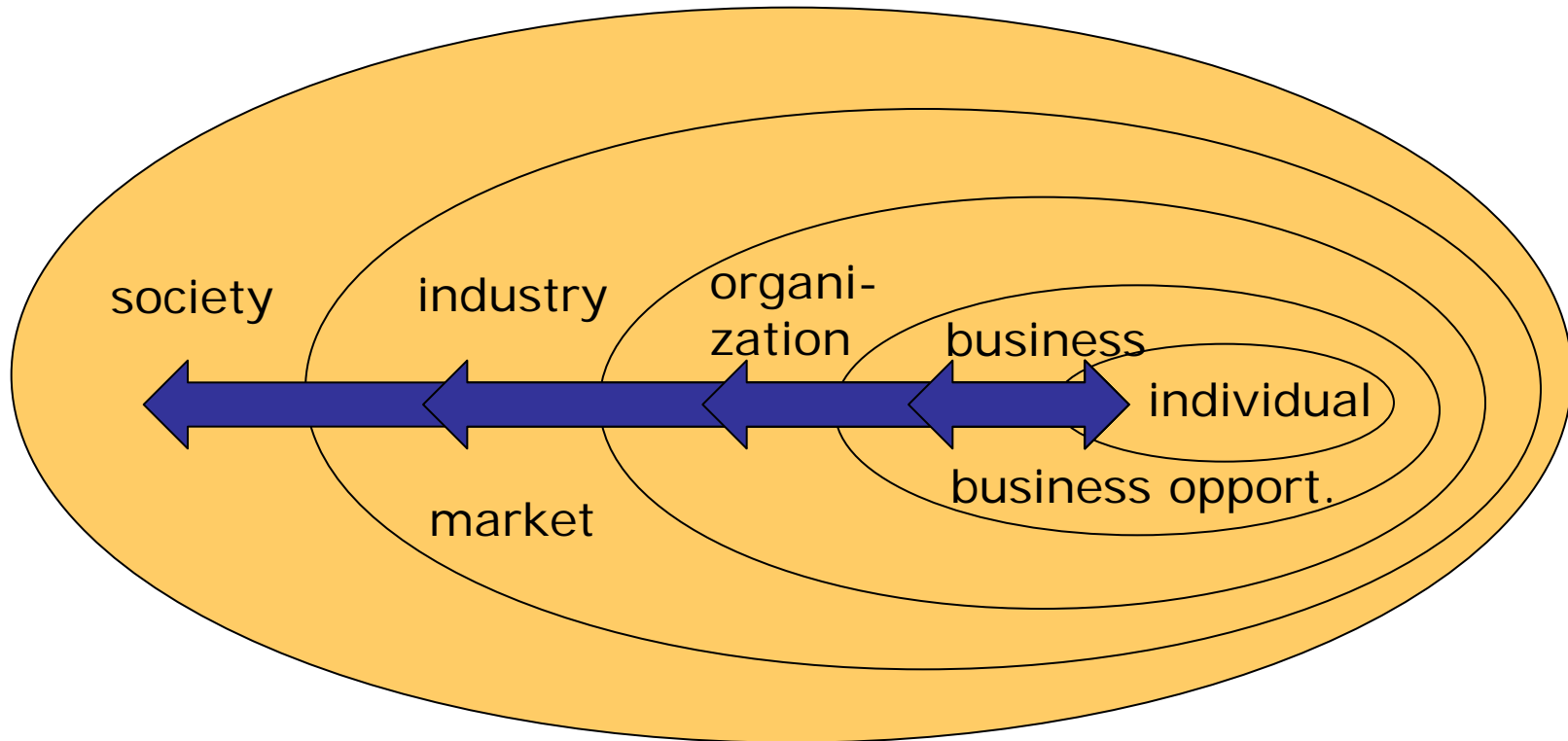
## Real economic life as frame for selecting adequate theories

- Volatility and oscillations
- Complexity (ubiquitous interconnectedness of things)
- Uncertainty (behavior, external events)

## Consequences and upcoming issues

- Evolution and co-evolution (on rather different ontological levels)
- Actors and re-actors
- Responsiveness and resilience of organizations required

No business is an island!



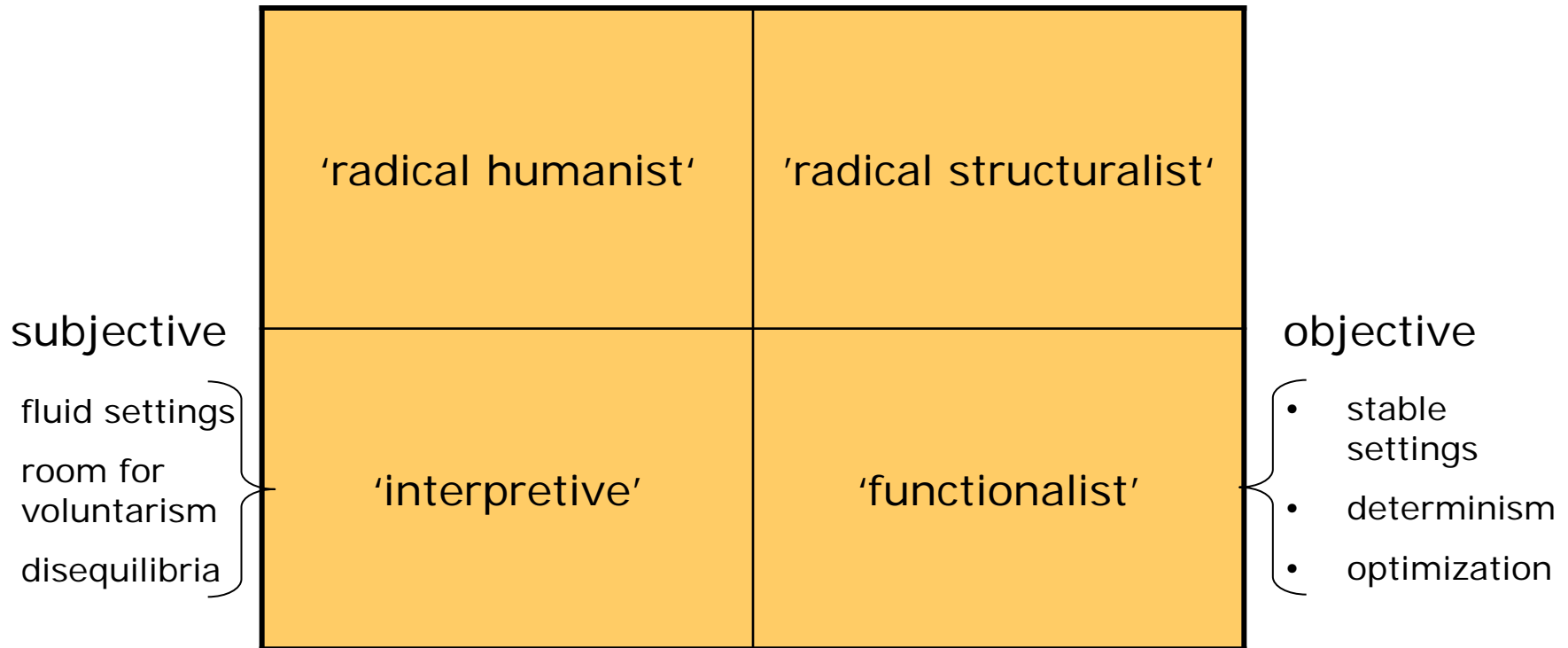
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- often recursive relationships
- multi-level impact of economic action
- interconnectedness: opportunities & threats – options?!

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Where do our theories come from?

the sociology of radical change



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Source: Burrell & Morgan 1979

Q: What do we need? A: More of everything!?

## Theories that explain ...

- evolution as well as shocks
- organizations and institutions that actively drive the run of events as well as organizations that are driven by the “business environment”
- idiosyncrasy of organizations as well as “laws” of the market place

... and all under an umbrella of antecedents that considers the “real world phenomena”

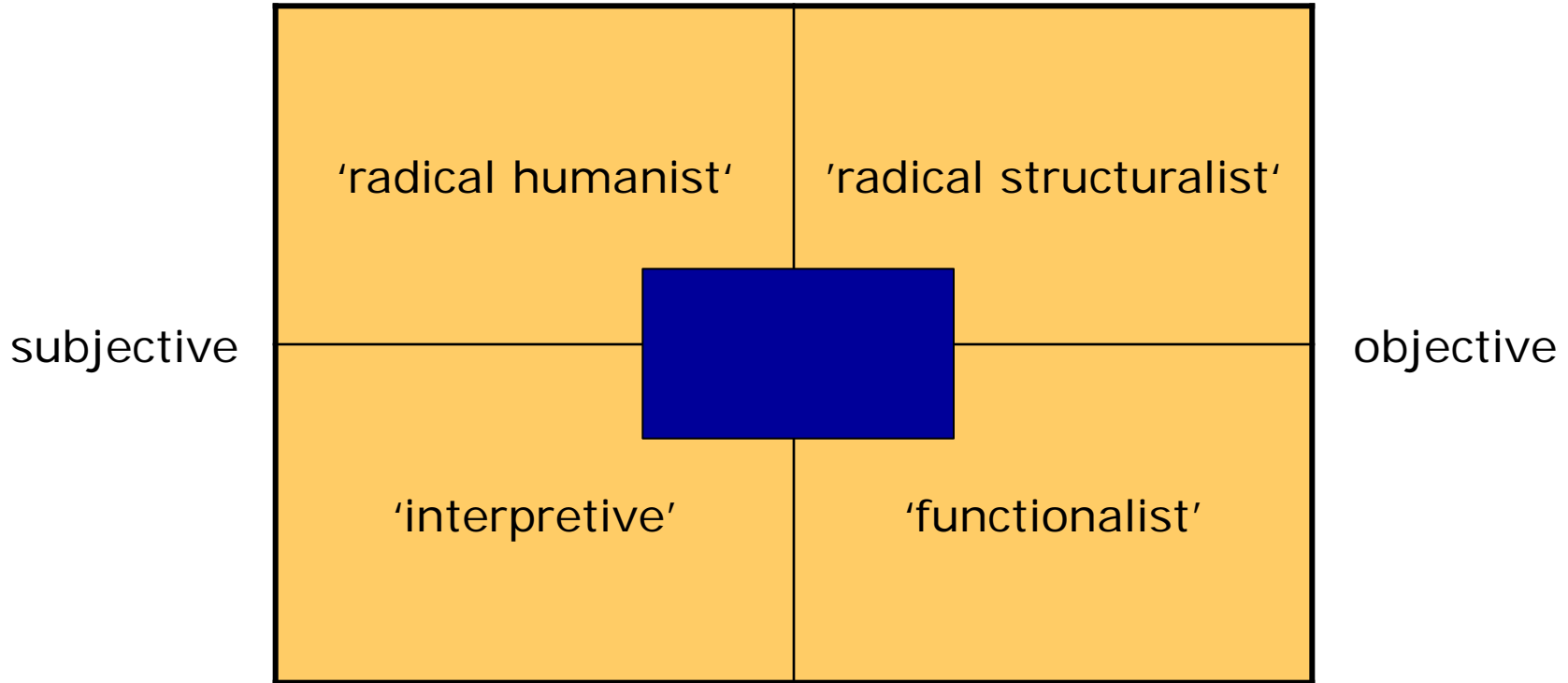
## Answers from recent OMT

- Resources and competences/dynamic capabilities
- Entrepreneurship and entrepreneurial spirit

## Other factors?

- Power
- Conflict

## the sociology of radical change

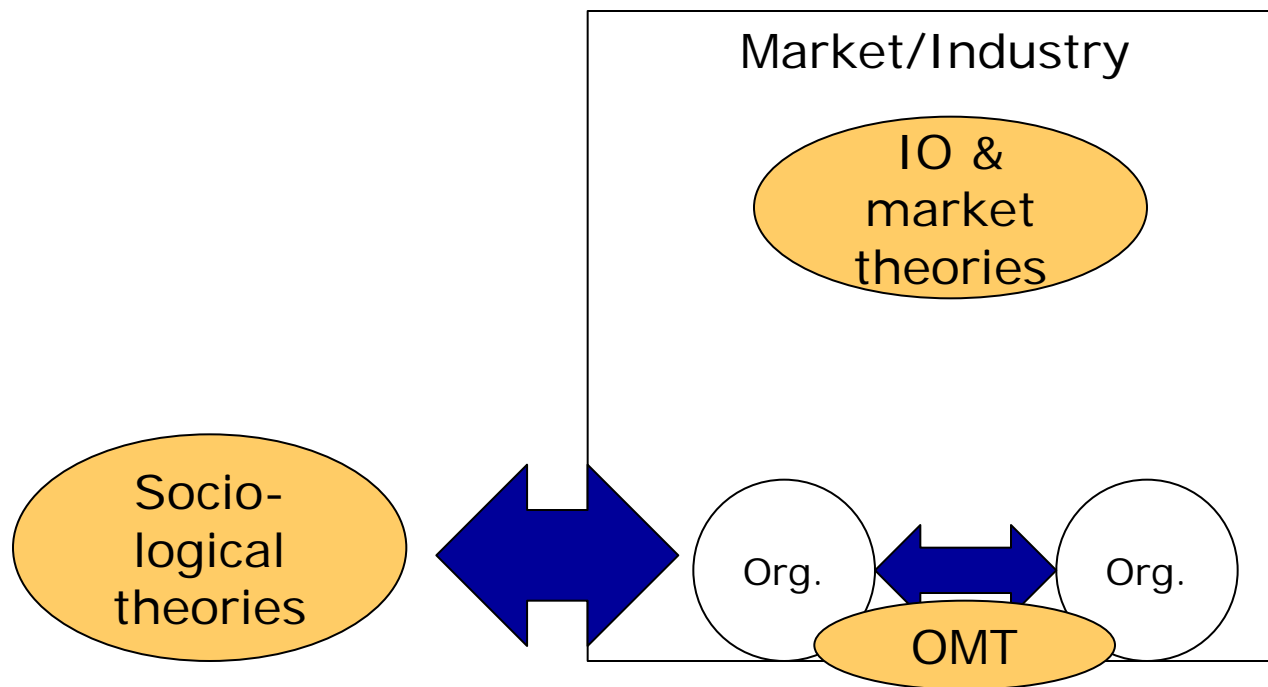


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Source: Burrell & Morgan 1979      the sociology of regulation

Theories 'at the core': building bridges – but: coherence? antecedents?

Society/social sphere



e.g. structuration theory,  
new institutionalism





## In spotlight

### Competence-based theory of the firm and its implications for strategic management

Why do we need a competence-based theory of the firm?

- RBV and DCA have never achieved to develop a consistent theory.

## Critics

e.g.

- Porter 1991
- Foss 1993 & 1996
- Knudsen 1996
- Priem/Butler 2001
- Kyläheiko et al. 2002
- Moldaschl/Fischer 2004
- Sanchez 2008
- Freiling et al. 2008

## Criticism

- terminology (fuzzy, confusing, inconsistent)
- tautological reasoning
- incommensurable approaches due to eclectic work
- ambiguous relation to market equilibrium
- low predictive power, only ex post explanations
- more static rather than dynamic character
- ...









## Competence-based theory of the firm and its implications for strategic management

Why do we need a competence-based theory of the firm?

- RBV and DCA have never achieved to develop a consistent theory.
- Research on resources and competences pinpoints facets of the firm that are useful to strategic management. E.g.:
  - The *idiosyncratic* firm: Every firm is unique.
  - The *evolutionary* firm: Every firm has its own history and evolution.
  - The *entrepreneurial* firm: Based on competences firms act entrepreneurially and have an impact on the environment.
  - The *(socially) embedded* firm.
  - Role of *uncertainty*: dark and *bright* side.
  - Competences stress the pivotal role of *inter-personal relationships* – maybe more than other theories of the firm do.







## Options

## Comment

- |  |   |  |
|--|---|--|
| • “forget it”  |   | • idea too precious  |
| • “try harder the same”  |   | • wrong track  |
| • “improve and move – step by step”                                    |   | • inadequate response to major weaknesses                                    |
| • “combine – find a good partner (theory) and benchmark best practice” |   | • impossible to locate partners without being aware of the theoretical basis |
| • “re-conceptualize and start over”                                    |   | • adequate – major change in the face of major problems                      |
| • “take the best [approach], forget the rest”                          |  | • possible as well   |

## Options

## Comment

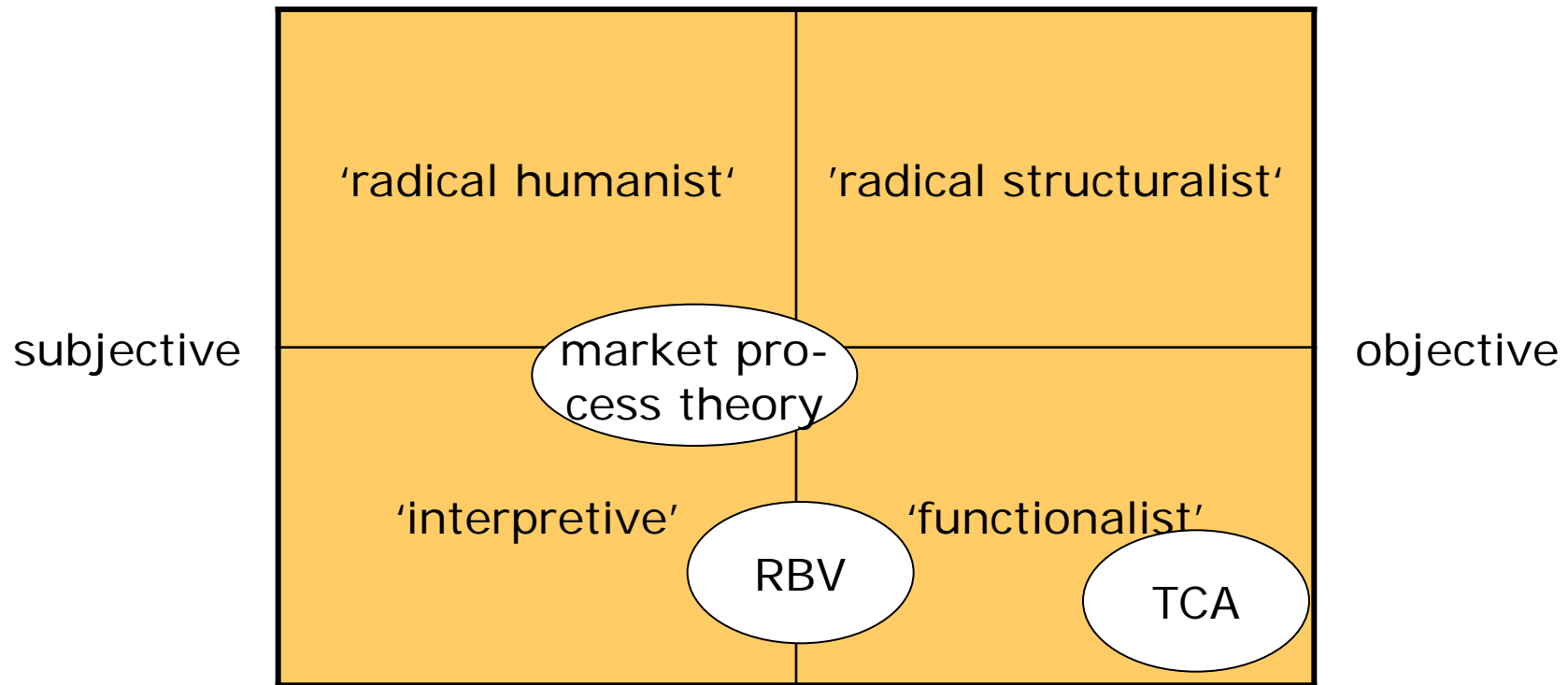
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## AGENDA

1. Identification of the very nature of competence research
2. Locating competence research in the landscape of management theories
3. Designing a re-conceptualized approach according to a concept of scientific research programs
4. Application: CbTF & real options

- evolutionary
- entrepreneurial touch
- non-deterministic
- people matter – and interpersonal relations
- division of labor matters - and unification of labor
- knowledge (and the use of knowledge) matters
- focus on idiosyncrasies in economic life
- future is uncertain
- co-evolution of firms and their economic environment

the sociology of radical change



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the sociology of regulation

Source: Burrell & Morgan 1979



## MPT & CBT

- sharing the same paradigm
- similar basic positions and way of thinking

### Market process theory

- theory of the market
- (use of) knowledge as driver of economic development

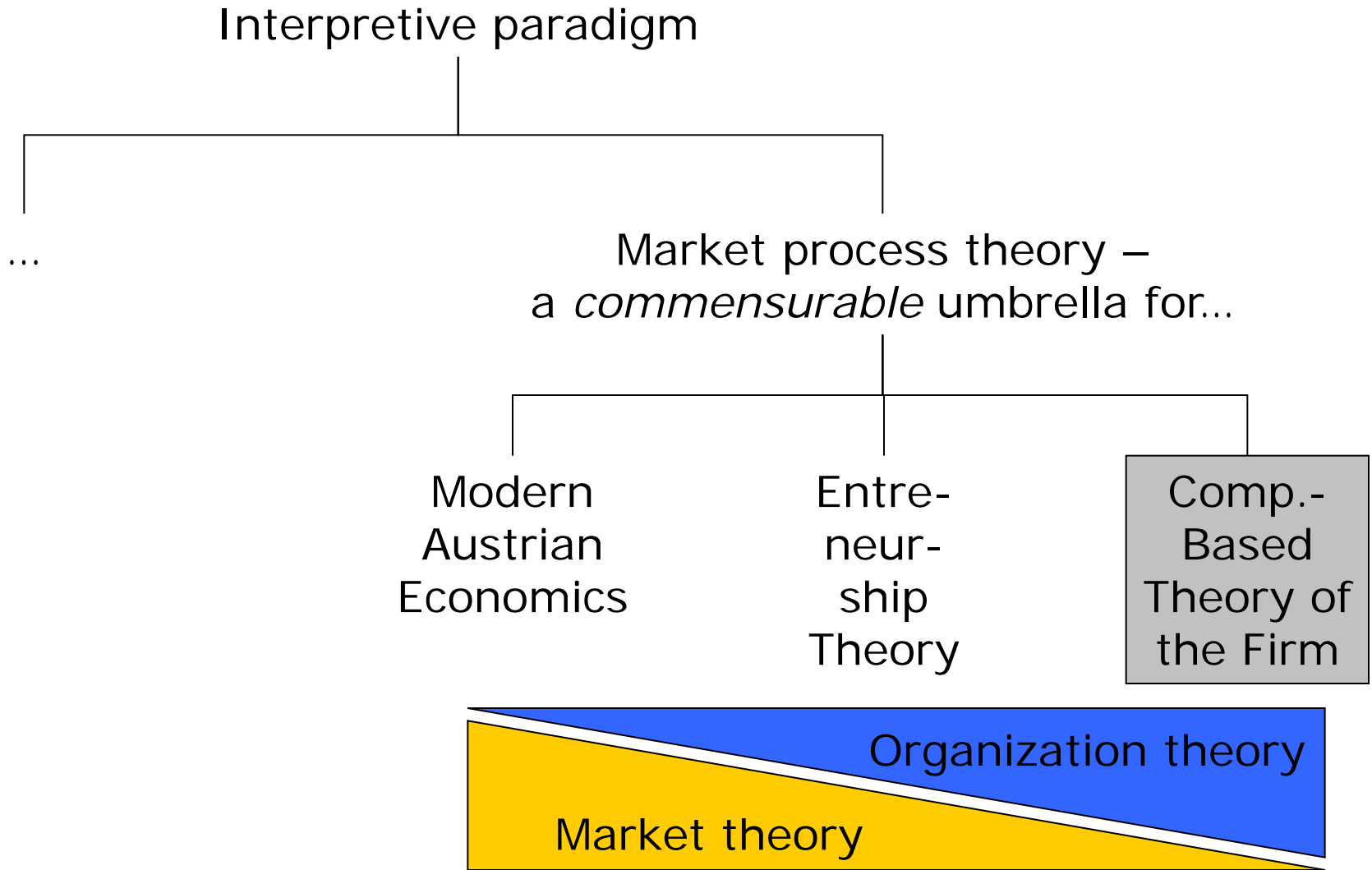
### Competence-based theory

- theory of the (idiosyncratic) firm
- knowledge and competences as drivers

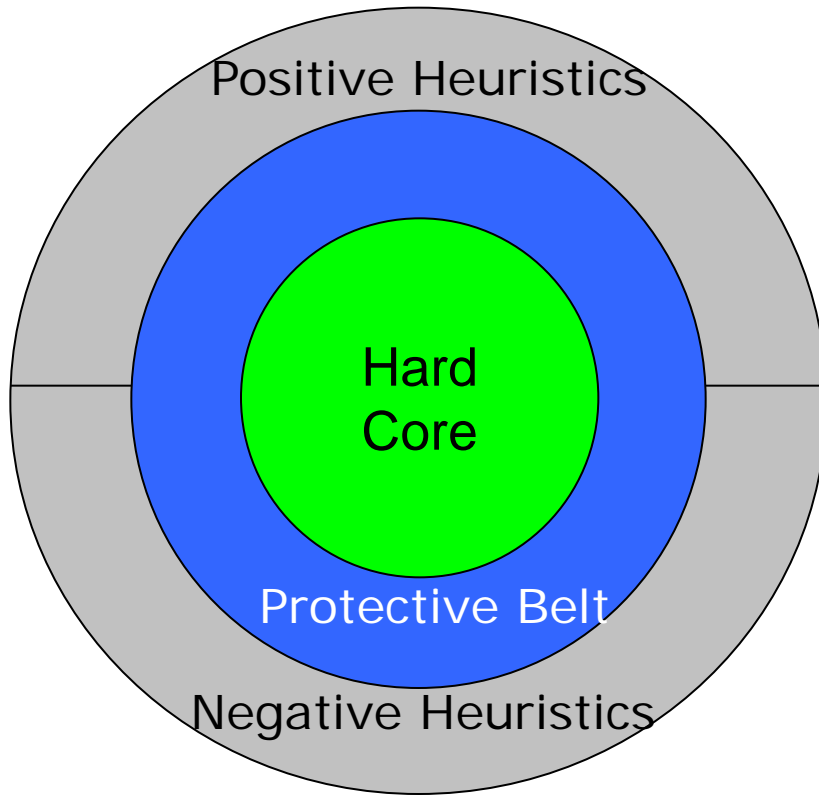
no explanation of the firm



Boettke (1994): 'missing chapter' of MPT

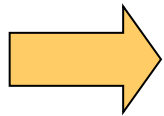


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The structure of scientific research programs according to Lakatos (1970)

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- Ambition: theory building based on Austrian School MPT
- Explanandum: existence and competitiveness of the firm
- Explanans: causal system of CBV (considering the role of uncertainty in causal chains)

Source: Freiling et al. 2008

**HCE 1:** *Subjectivism* - Economic players differ in what they know, what they want and what their capabilities are.

**HCE 2:** *Radical uncertainty.*

**HCE 3:** *Methodological individualism* - decisions are made by individuals.

**HCE 4:** *Homo agens* - The individual is an 'acting man'.

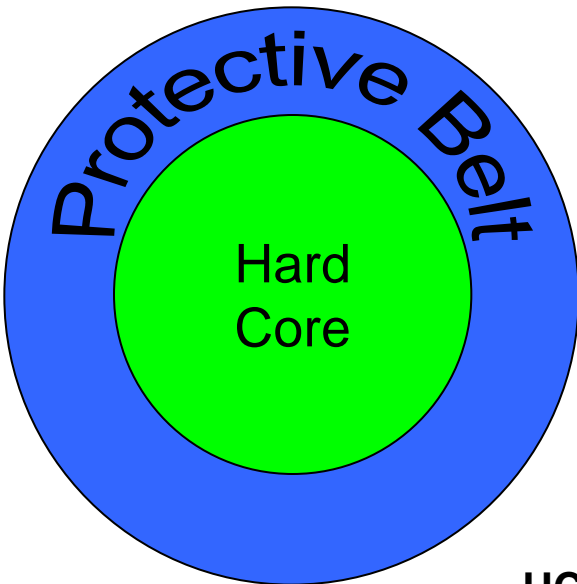
**HCE 5:** *Moderate voluntarism.*

**HCE 6:** *Time* - matters.

HCE: hard core element

CbTF: Competence-based Theory of the Firm

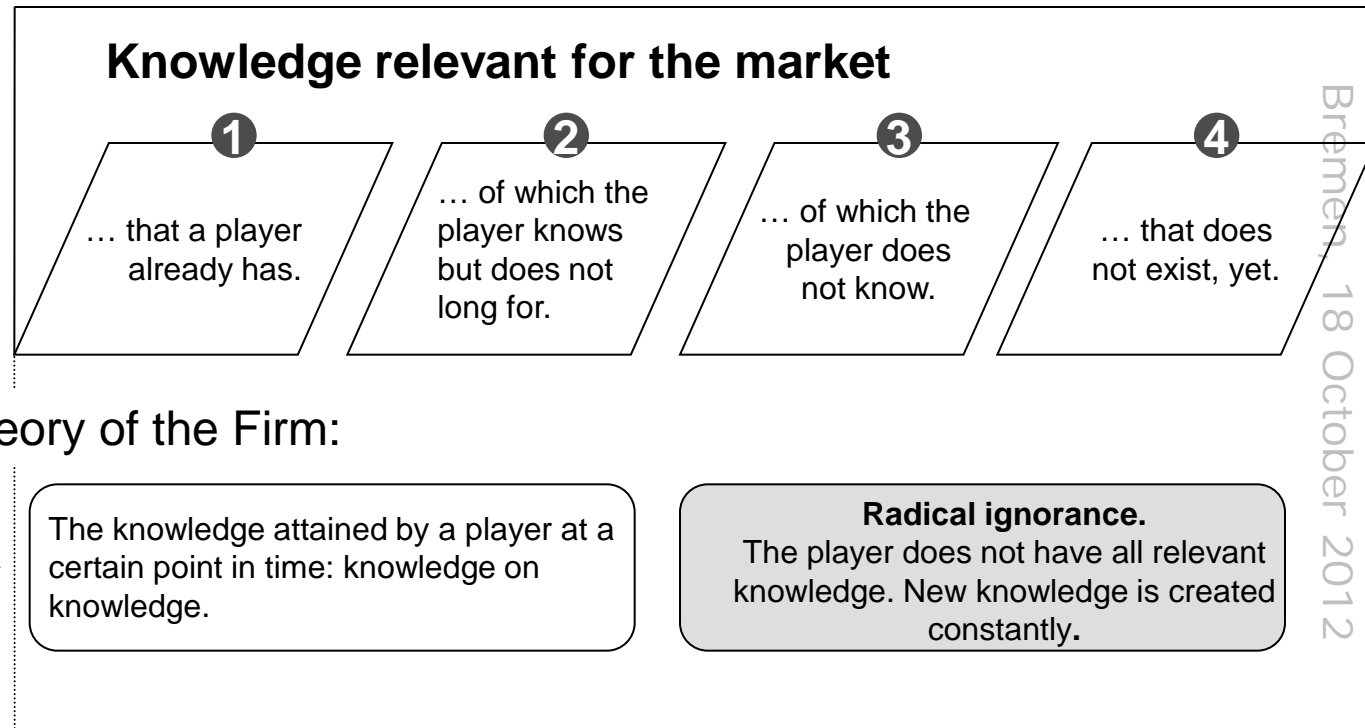
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Verbeke & Greidanus (2009: 1487)

“Bounded reliability as an envelope concept includes two main components, within the context of global MNE management: opportunism as intentional deceit, and benevolent preference reversal.”

- People often act in good faith (although opportunism is possible in principle).
- People are not always able to keep their promises – over-confidence.
- People are not always skillful enough in the things they do.



Source: adapted from Lachmann 1978; Rese 2000: 70

Source: Freiling et al. 2008

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CbTF: Competence-based Theory of the Firm

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# Time matters: knowledge accumulation and competence building

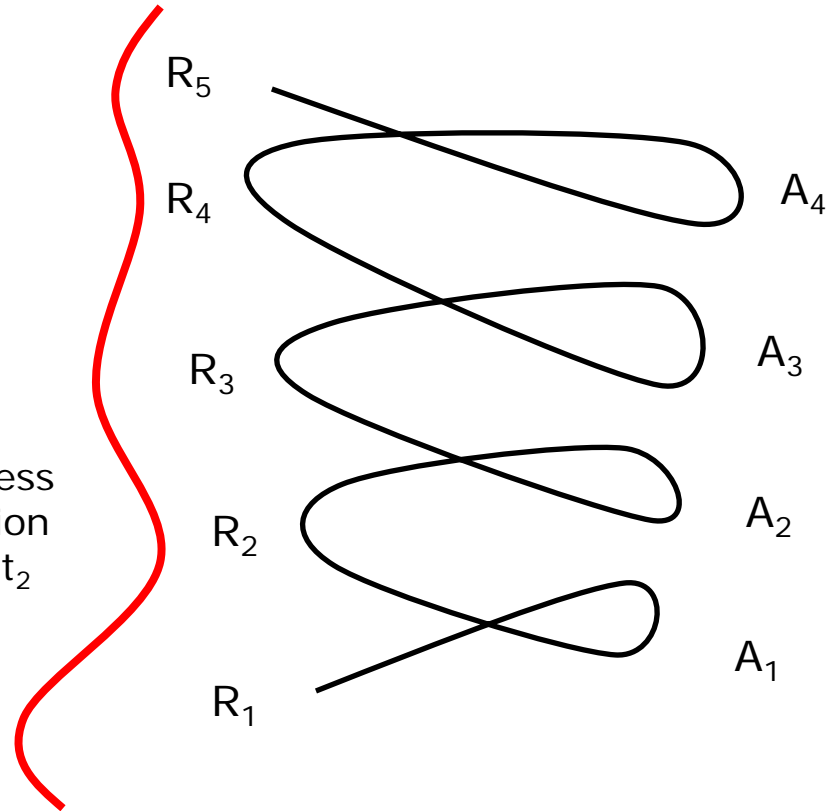
Readiness for action  $x_1$  in  $t_1$



Action (application and creation of new readiness)



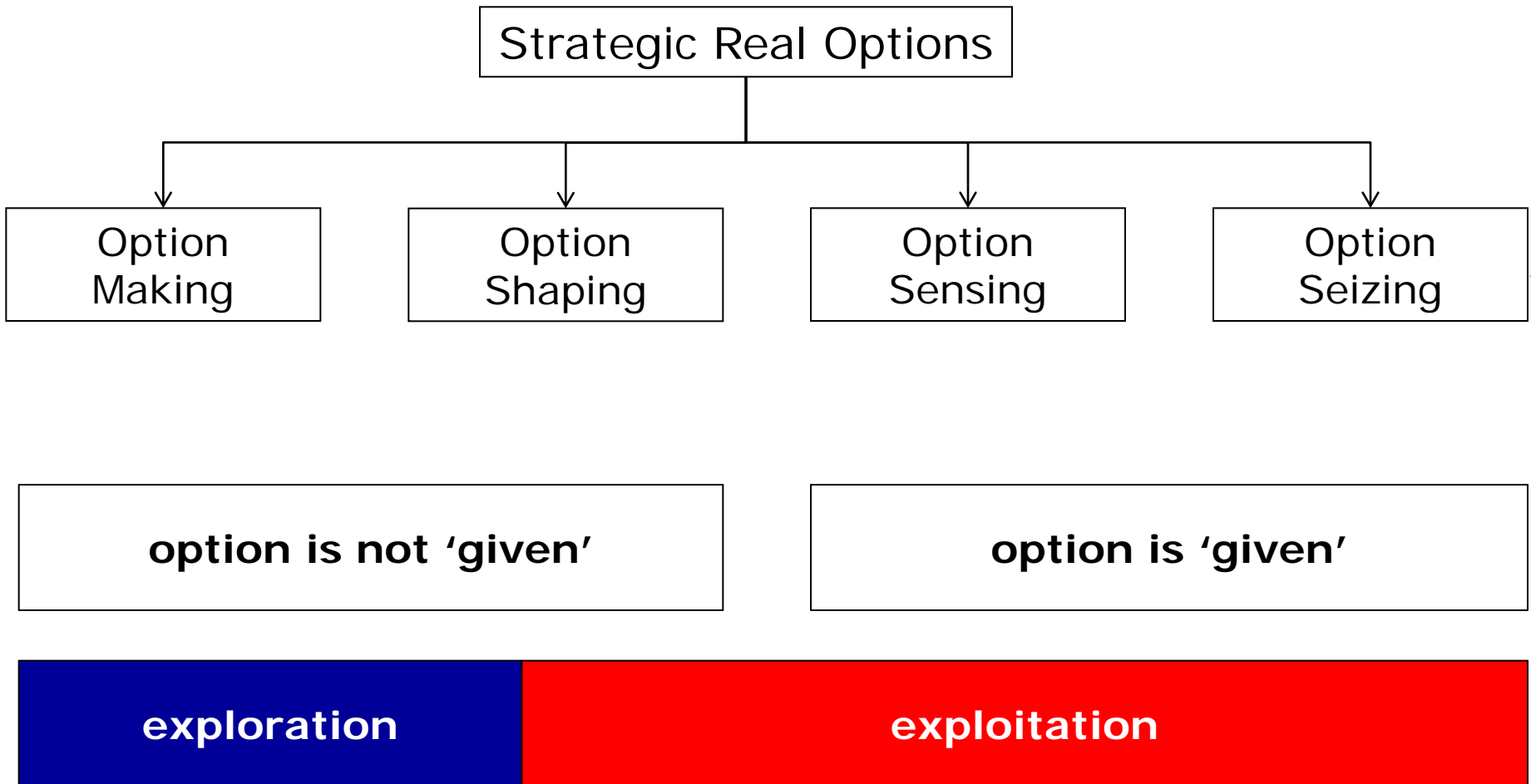
Readiness for action  $x_2$  in  $t_2$



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Source: adapted from Ortmann 2004: 13





Intellectual Leadership	Management of Migration Paths	Competition for Market Share
<p>Gaining industry foresight by probing deeply into industry drivers.</p>	<p>Preemptively building core competencies, exploring alternate product concepts, and reconfiguring the customer interface.</p>	<p>Building a worldwide supplier network.</p>
<p>Developing a creative point of view about the potential evolution of:</p> <ul style="list-style-type: none"> <li>• functionality</li> <li>• core competencies</li> <li>• customer interface</li> </ul>	<p>Assembling and managing the necessary coalition of industry participants.</p>	<p>Crafting an appropriate market positioning strategy.</p>
<p>Summarizing this point of view in a "strategic architecture".</p>	<p>Forcing competitors onto longer and more expensive migration paths.</p>	<p>Preempting competitors in critical markets.</p>
		<p>Maximizing efficiency and productivity.</p>
		<p>Managing competitive interaction.</p>

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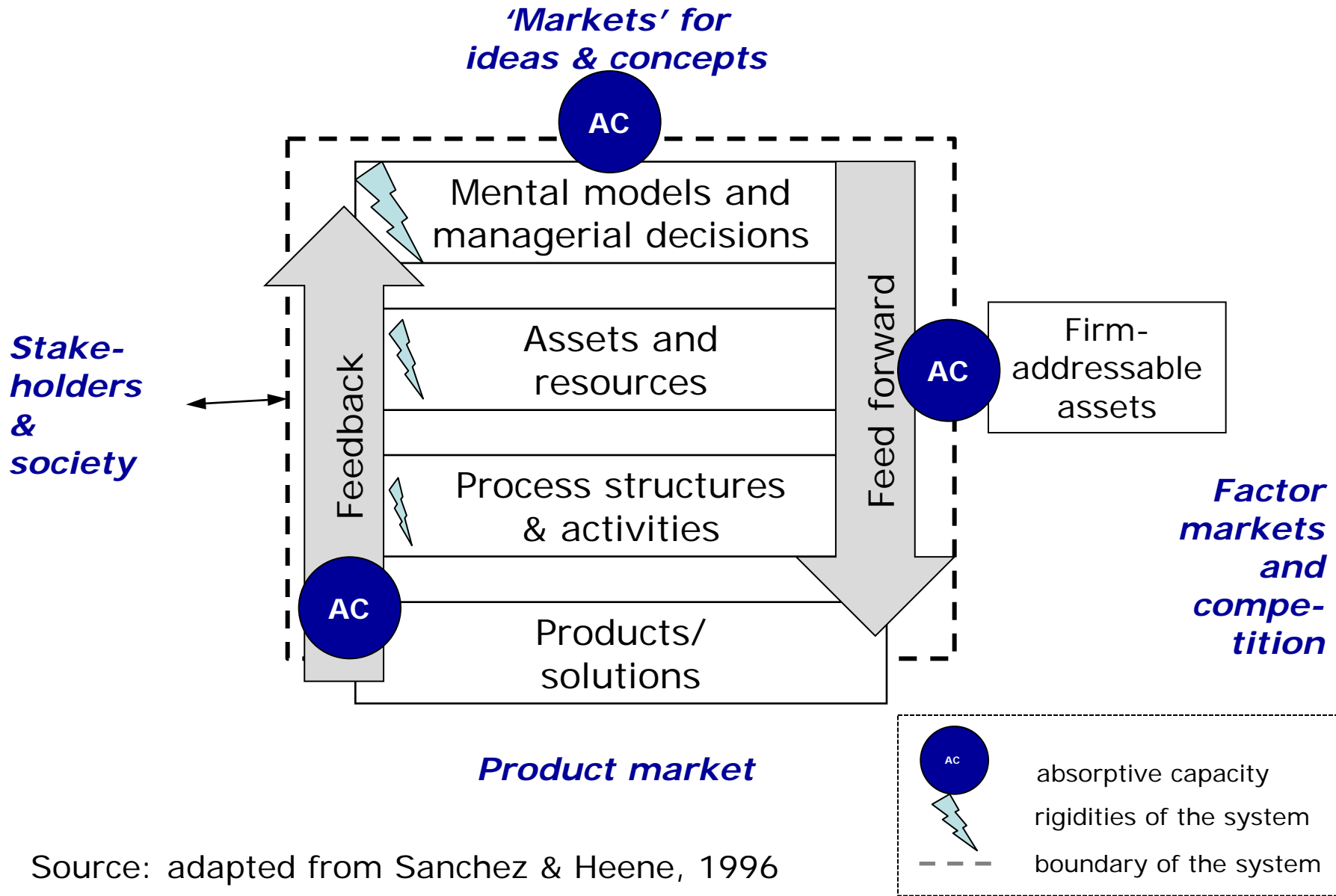
Source: Hamel & Prahalad 1994: 47

Real options: vehicles for an entrepreneurial strategic management (benchmarks of competence development, providers of strategic responsiveness, etc.).

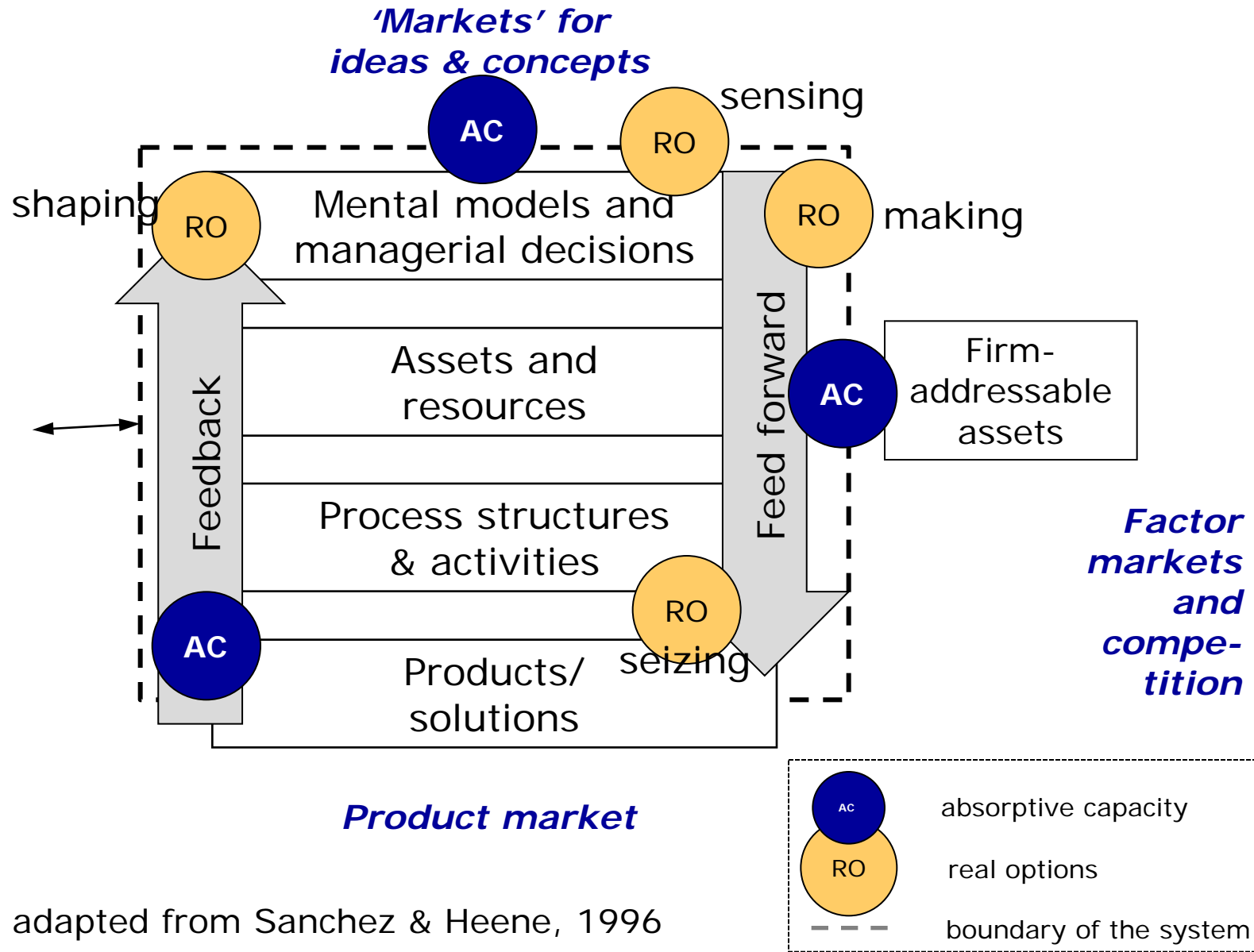
Real options: may emerge in every phase of competence-based competition.

Making, recognizing, and exploiting real options depends on available competences and dynamic capabilities.

Entrepreneurial competences seem to be of utmost importance in this respect.

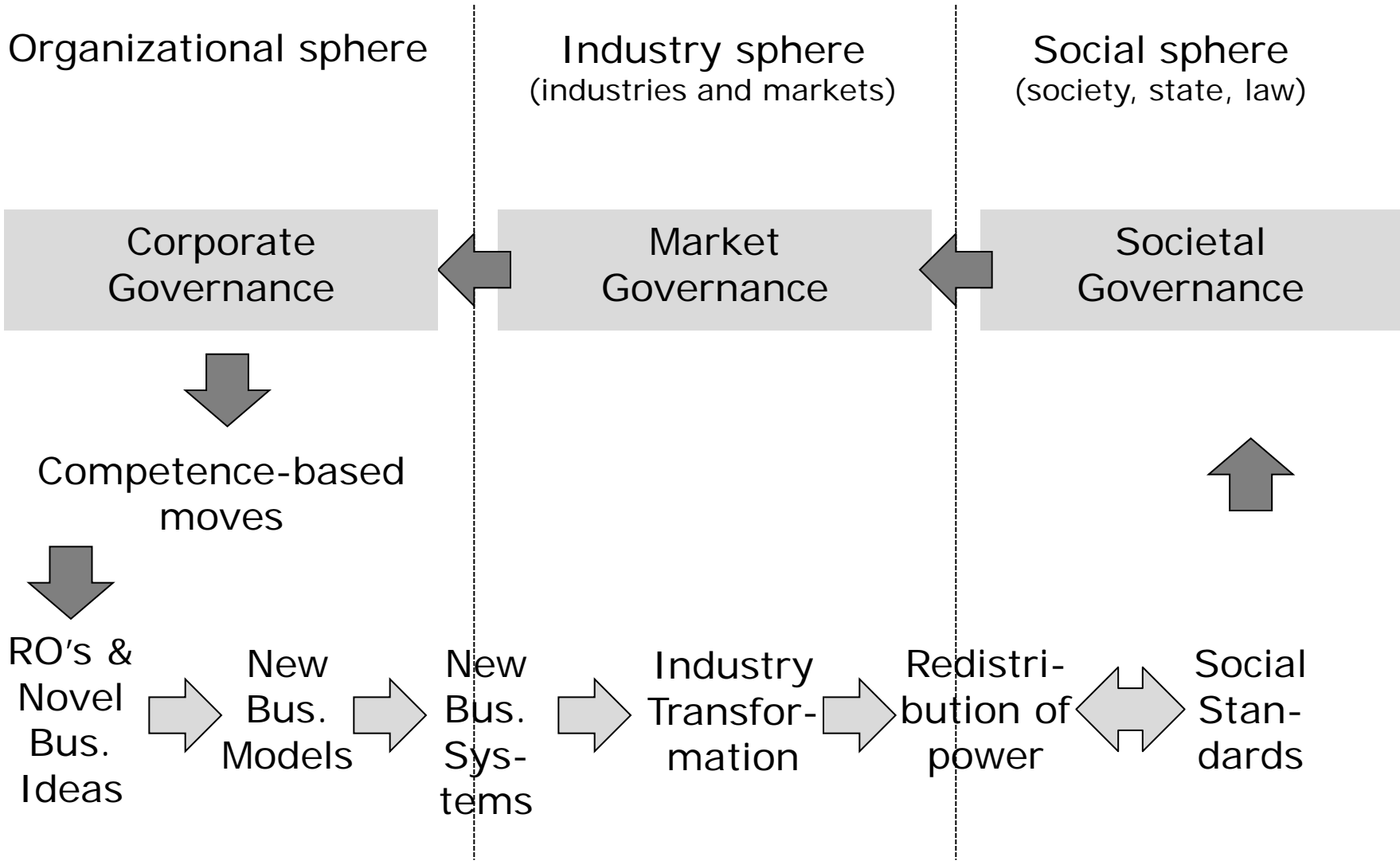


Source: adapted from Sanchez & Heene, 1996



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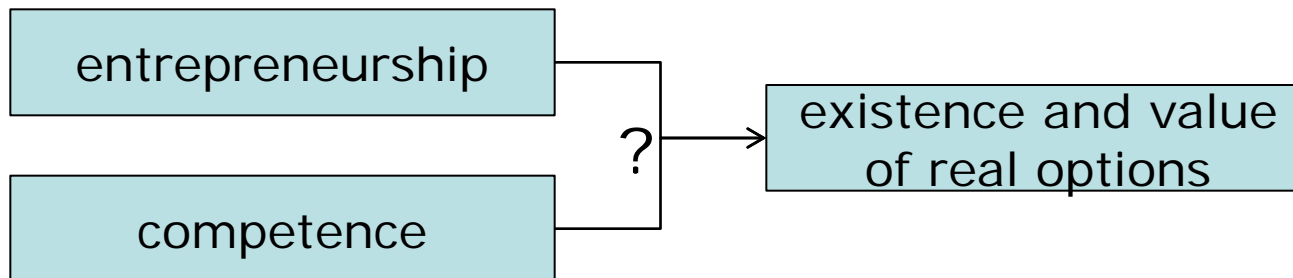
Source: adapted from Sanchez & Heene, 1996



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- Real options – different managerial settings: risk vs. uncertainty
- Why, how and when do real options emerge and develop?
- How much do imagination and cognition matter as for the management of real options?



# D

iscussion

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## Theoretical Frameworks for Addressing Strategic Real Options

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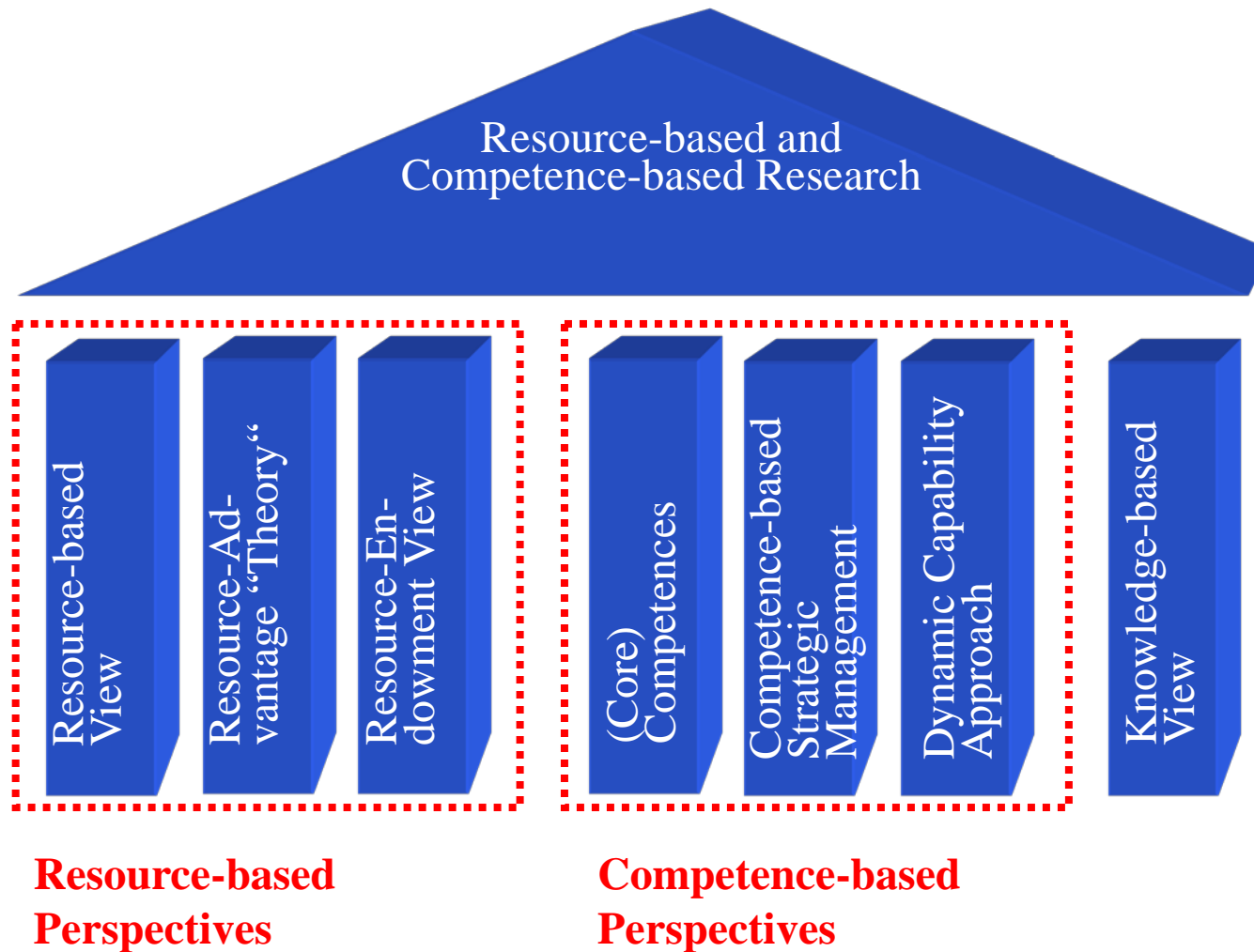
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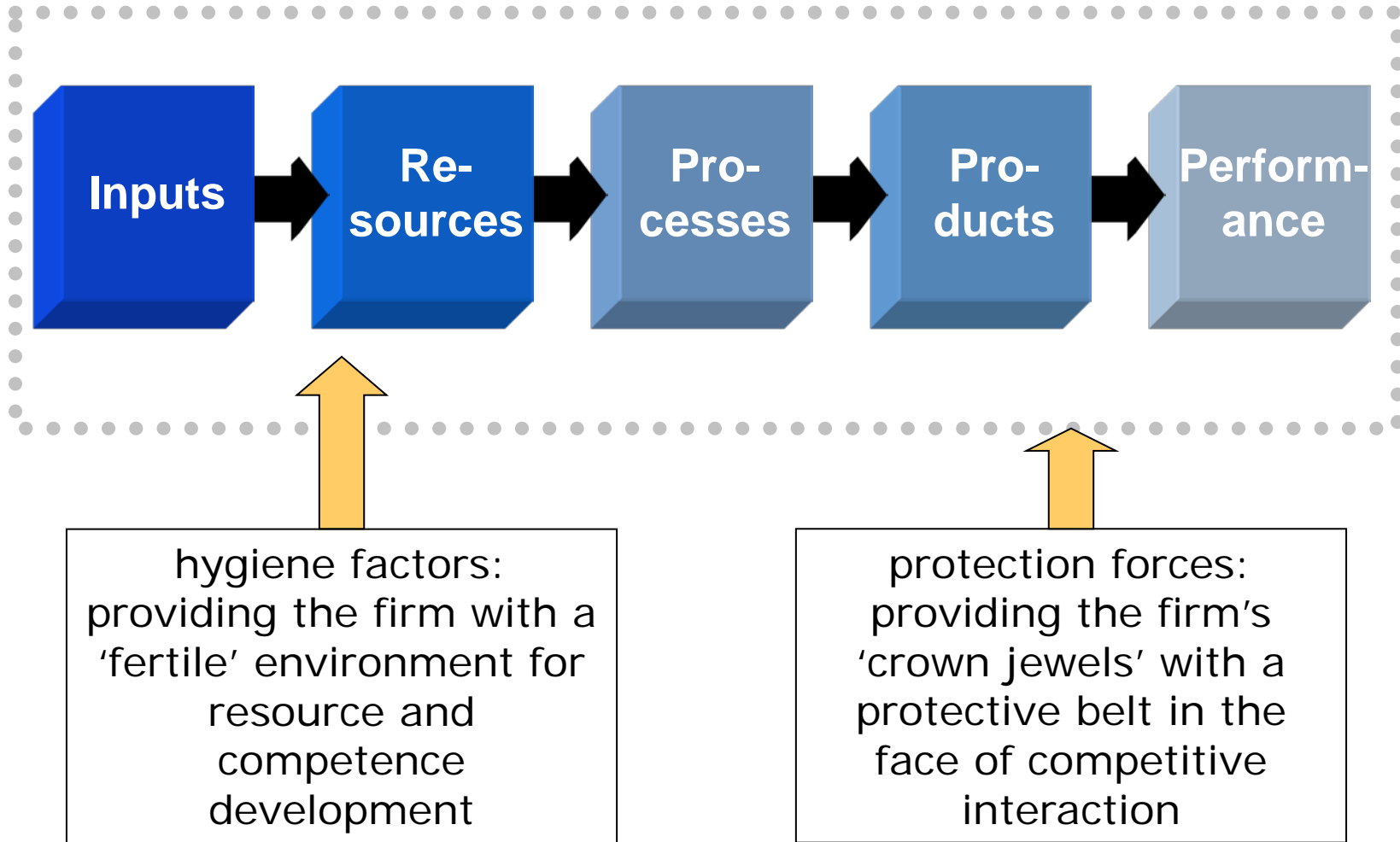


	Finite resources	Regenerative resources	Generative resources
Character	depreciation in use	sustainability as long as principles of the system regarded	appreciation in use
Logic of use	restrictive -> efficiency	sustaining	expansive, lavish
Examples	materials	labor	skills, knowledge, social relations

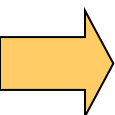
Source: Moldaschl 2005

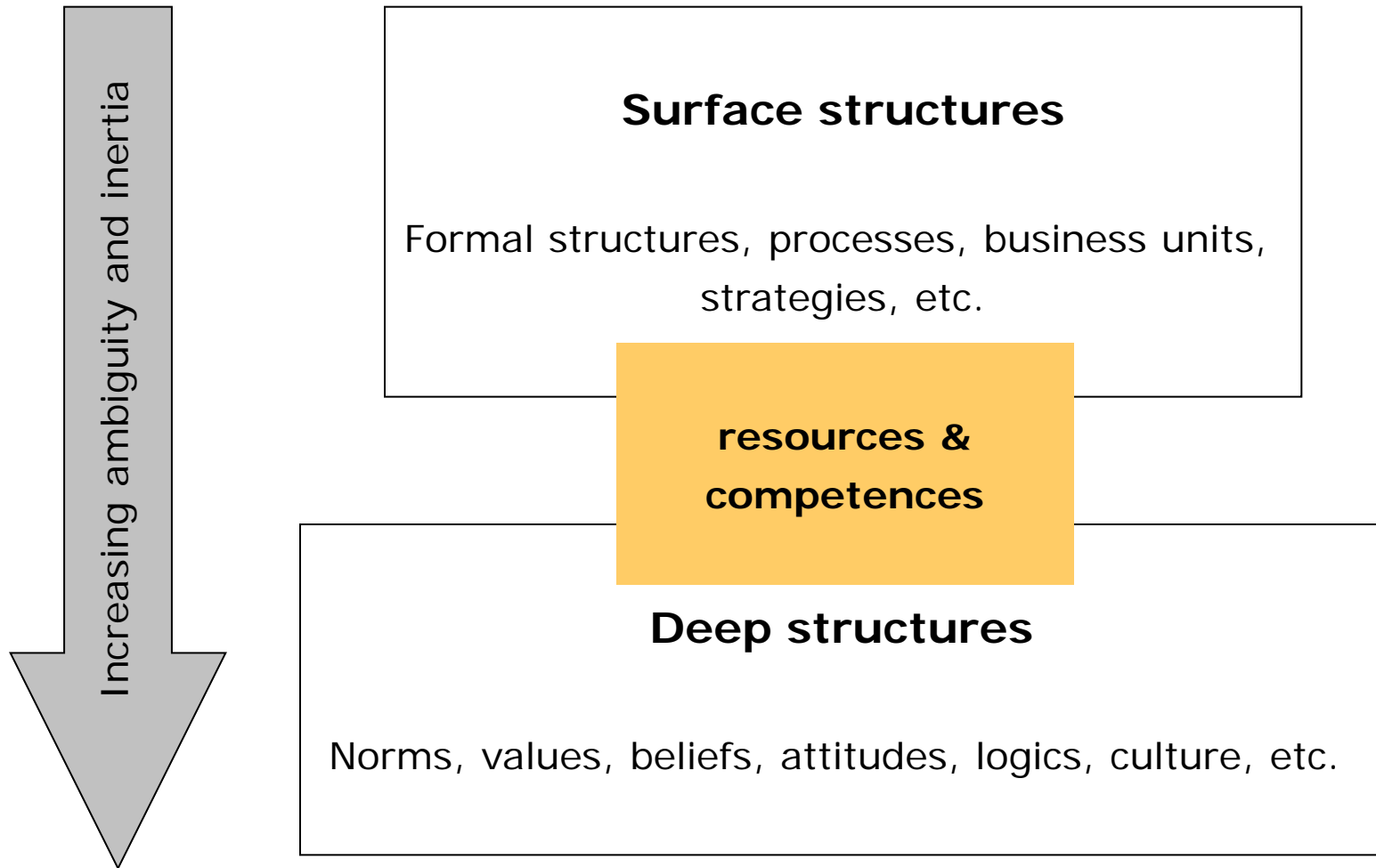
For the management of strategic real options, generative resources seem to matter much.





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 *Firms offer specific stable, not static environments for R&C nurturing.*



→ firms: offer an **organizational ambiance** fostering R&C building

Due to the organizational ambiance firms are more than safe ports in troubled seas of uncertainty

... a net of specified and well-adapted resources ...

... that provides the firm with a stable, not static environment for coordination ...

## organizational ambiance

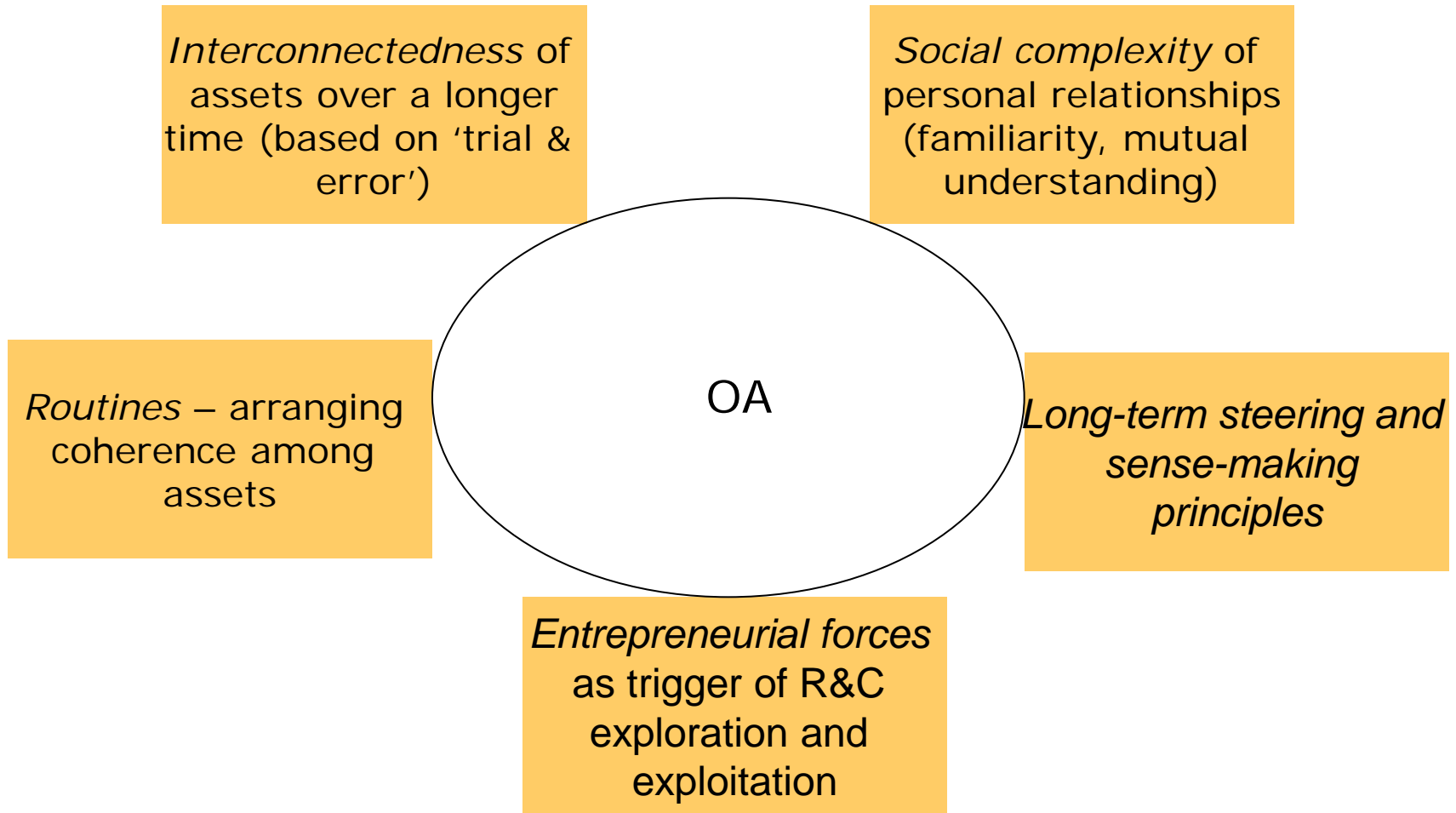
..., so that a nurturing of resources and competences occurs and a protection from third-parties takes place.

...based on mental and structural couplings in the resource endowment ...

..., developed and refined over time by permanent use and improvements ...

- firm-specific background
- for resource building, leveraging, and using
- consisting of relatively stable, but not static structural elements and ties between them

# What is the 'ambiente' made of? The role of the 'isolating mechanisms'



# The potential offered by firms

... in the light of the hard core elements of CbTF

HCE 1	Subjectivism	synergies by pooling intellectual and other forces of the different kind
HCE 2	Radical uncertainty	radar & interpretation system: reducing the unavoidable uncertainty (risk <b>and</b> opportunity oriented)
HCE 3	Methodological individualism	creating values, identities, mutual understanding based on the actions of individuals
HCE 4	Homo agens	increasing the potential of proactive behavior by entrepreneurial division & unification of work
HCE 5	Moderate voluntarism	increasing the power by pooling the assets and forces
HCE 6	Time	triggering asset mass efficiencies by overcoming critical thresholds



“The essential difference between economic activity inside the firm and economic activity in the ‘market’ is that the former is carried on within an administrative organization, while the latter is not.

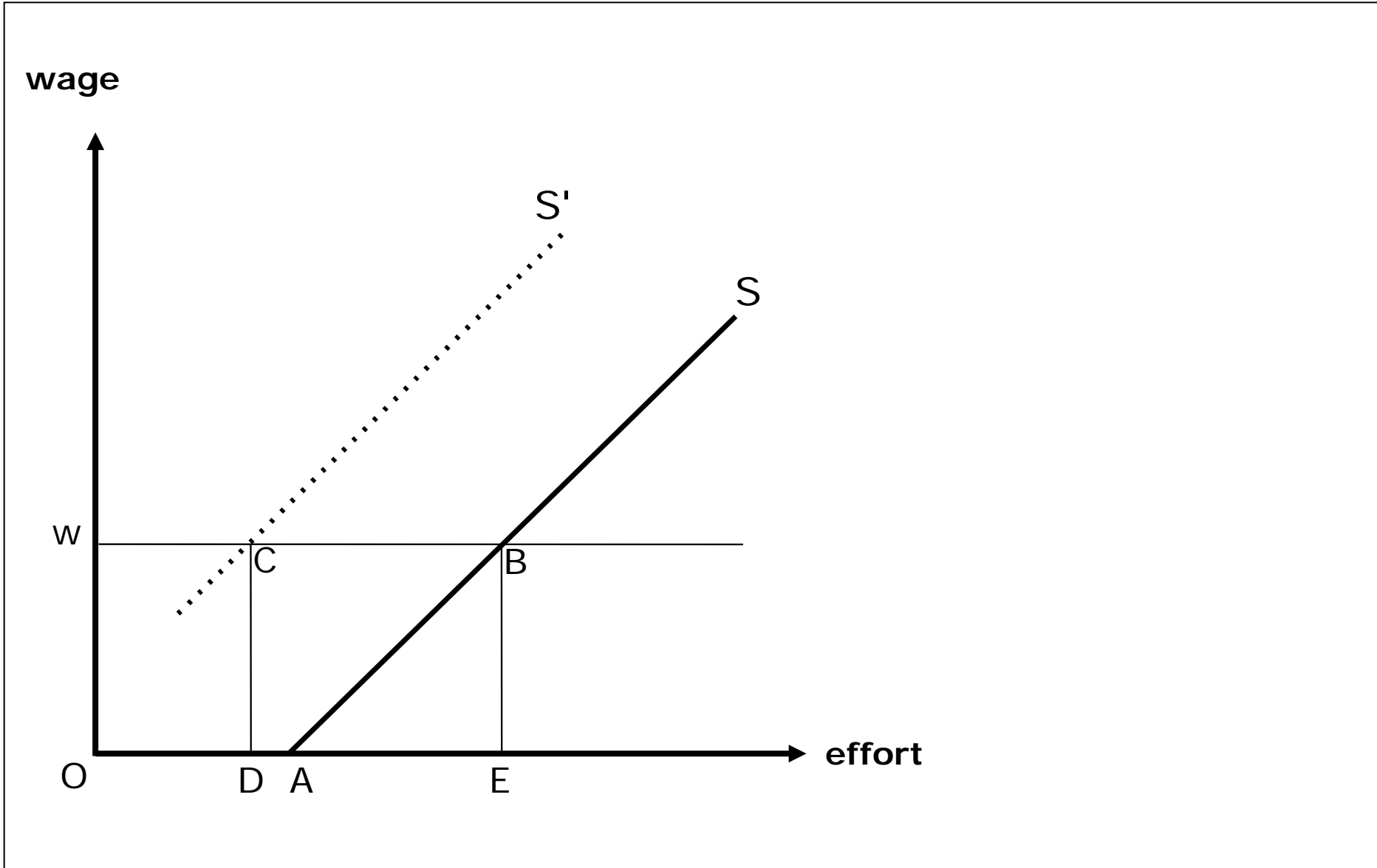
(...) A firm is more than an administrative unit; it is also a collection of productive resources the disposal of which between different uses and over time is determined by administrative decision.” (*Penrose 1959: 25*)

“The fact that most resources can provide a variety of different services is of great importance for the productive opportunity of a firm. It is the heterogeneity, and not the homogeneity, of the productive services available or potentially available from its resources that gives each firm its unique character.” (*Penrose 1959: 75-76*)

- developing individual knowledge and skills – internally or in connection with external absorption
- connecting and restructuring individual knowledge and skills
- transferring skills and knowledge between different organizational levels (individual, team, organization)
- developing new patterns of action

understanding competence building as a process of organizational learning

# The Motivation Problem of Markets



# Terminology

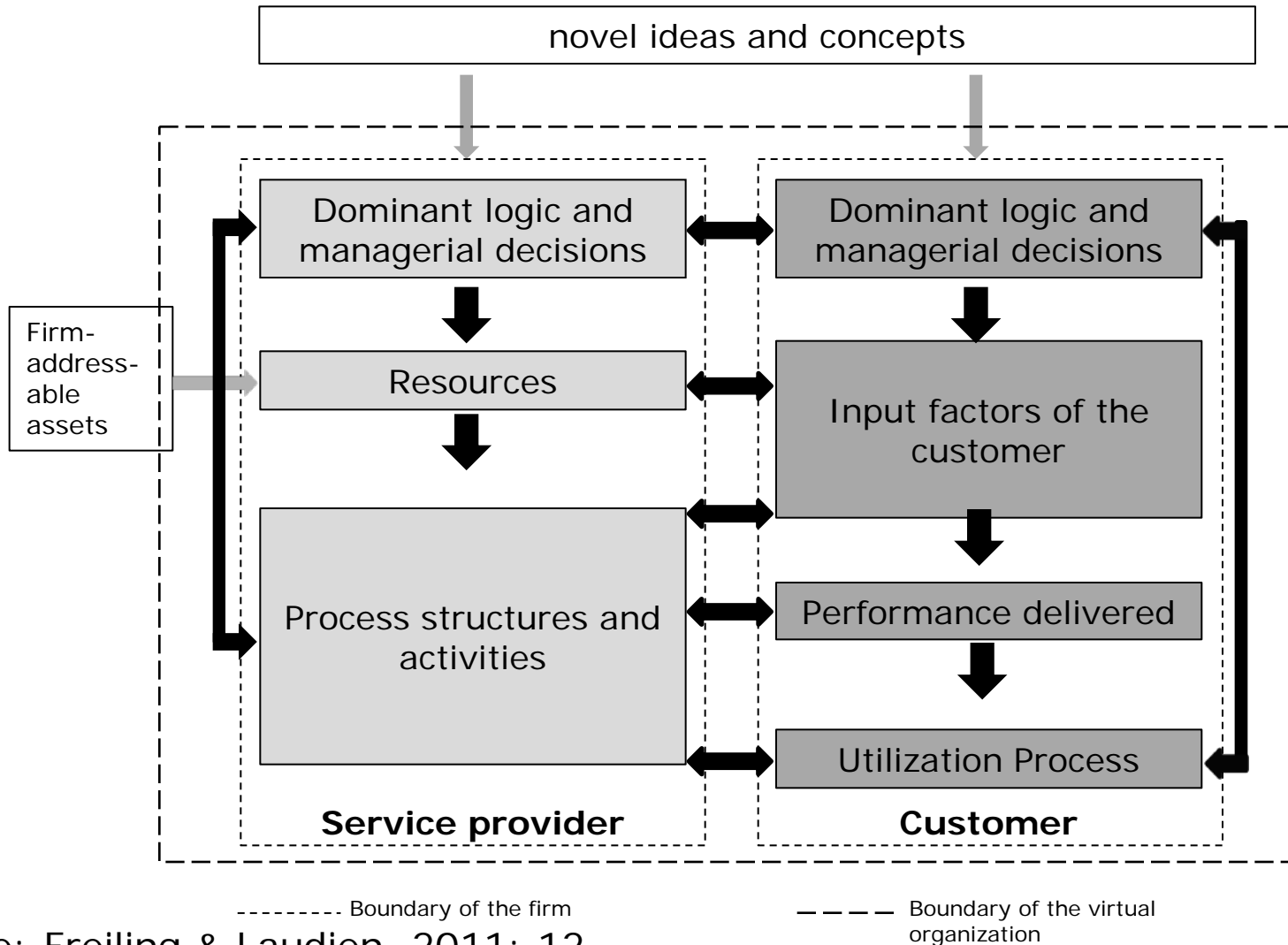
- **Assets** are homogeneous external or internal factors which can usually be procured in markets, serving as input for value-added/upgrading processes.
- **Resources** can be understood as those assets which have undergone a firm-specific upgrading process. They (should) mainly contribute to the actual and future competitiveness of a firm and thus account for the firm's heterogeneity.
- **Competences** mean a repeatable ability of rendering competitive output. This ability is based on knowledge, managed by rules and thus non-random. They enable goal-oriented processes to arrange future performance potentials as well as concrete input to the market. Competences cater for a conservation of competitiveness and if so even competitive advantages.

# Problems of Competence Research

Definitions	<ul style="list-style-type: none"><li>- heterogeneity of meanings</li><li>- inappropriate alignment with explanandum</li></ul>
Assumptions	<ul style="list-style-type: none"><li>- ambiguous assumptions</li><li>- no proper reflection of the CBV nature</li></ul>
Explanation object	<ul style="list-style-type: none"><li>- made a later step first</li></ul>
Research methodology & reasoning	<ul style="list-style-type: none"><li>- over-emphasised metaphors</li><li>- eclecticism</li><li>- incompatibilities</li><li>- circular reasoning</li><li>- ex-post explanations</li></ul>
Fundamental understanding	<ul style="list-style-type: none"><li>- voluntaristic touch adequately acknowledged?</li><li>- market equilibrium vs. market process</li></ul>

Cf. Freiling et al. 2006

## The Case of Novel Service Concepts



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Source: Freiling & Laudien, 2011: 12

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