BOOK REVIEW

Theory of the Firm for Strategic Management: Economic Value Analysis

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Theory of the Firm for Strategic Management: Economic Value Analysis
Manuel Becerra
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The book is motivated by the lack of a core strategic theory of what firms do and their performance in the market and aims at developing a reasonably comprehensive theory of the firm for strategic management. In this regard, the book provides answers to the four major questions that a theory of the firm for strategy should address: what is a firm, why does it exist, what determines its size and scope and what its performance through time.

The introduction sets the conceptual basis on which to develop a theoretical strategic approach to the multifaceted idea of firm that identifies the reasons for either its success or failure. The multidisciplinary character of strategy, that may be defined from economical, sociological and psychological perspectives, together with the wide range of approaches to the concept of firm require a comprehensive literature and concept review that allow the author to shape into form the main ideas introduced through the book. The author concentrates its theoretical formulation on the contracting solution, [governance structure of transactions], and collection of resources concepts of firm. However, elements from the remaining theories of the firm, i.e. firms as production units [profit maximizing “black boxes”] and decision making processes, [coordinators and information processors], remain inherent to the main developments of the theory.

The book presents a comprehensive model that combines the transaction costs economics [defining the boundaries of a firm] and resource-based view [studying its performance and competitive advantages] approaches with the notion of economic value to define firms as value-creating and appropriating units in direct competition with each other for resources and customers. Selection and performance operate through a path-dependent process where those firms able to create more value by combining cospecialized assets enjoy a higher perfor-
mance whose duration depends on the ability of competitors to replicate the specific resource combinations of highly performing firms.

The book is divided into two main parts. The first five chapters develop a theory of the firm for strategy based on the notion of economic value and its creation and appropriation by independent value-creating units called firms. The remaining chapters consider the strategic management of internal resources and its main goals: understanding the reasons for the success or failure of firms and achieving a profitable position for the firm in different products and geographical markets.

The second chapter introduces the idea of firm as a contracting solution for managing relationships and suggests that economic value analysis should include the notion of transaction costs to understand the emergence, size, scope and performance of firms. At the same time, the chapter exposes the limits faced by transaction costs economics (TCE) when providing the basis for a theory of the firm in strategic management. In this regard, it is suggested that TCE should widen its scope beyond opportunism and asset specificity as the main reasons for the existence of firms; this is due to the fact that firms are not only mere governance structures of transactions but also value creating entities whose boundaries are determined by other firms and their corresponding value creation processes.

The third chapter constitutes the theoretical core of the book. This chapter focuses on expanding the resource-based view of the firm to illustrate how firms combine internal and external resources to create value for their targeted customers [using resource management as the main foundation for their strategy] in the presence of direct and potential competitors for both resources and customers [that determine the market positioning of firms]. Selecting the resources to combine under a given strategy [whose boundaries are drawn around the collection of internal resources that share a common strategic direction set at a higher than independent level using the common interface defined by the firm] in order to deal with customers, competitors and other external resources results in different relative performances when creating and appropriating value for the collection of internal resources that constitute the firm.

In the same vein, the fourth chapter presents the main sources of economic value creation for firms, ranging from the enhancement of customer benefits and increments in firm efficiency to the reduction of monetary and non-monetary customer costs. For economic value to be created improvements over the existing “state of the world” must take place, that is, an innovation either in products or processes, or both, must occur. In this regard, the key challenge for strategy scholars is the development of better ways to analyze the value that innovations may generate for customers.

The fifth chapter deals with the appropriation of value by firms and draws its main ideas from economics when defining the contextual conditions required for profits to emerge and the barriers to competition that may sustain profits through time. In this case, it is their heterogeneous potential to create value, given the specificity of their available resources, and to solve the uncertainty faced in the process what allows firms to generate [and appropriate] profit differentials. Moreover, the dynamic sustainability of profits depends on the ability of competitors to replicate and substitute the specific resource combinations of a given firm, which behave as entry barriers to its market.

The sixth chapter defines the business strategy of a firm as the combination of resource management activities, barriers to competition and market positioning that result from the firm’s interaction with resources, competitors and customers to create and capture value. The author moves beyond Porter’s categorization of business strategies and away from the discussions favouring either positioning or internal resources approaches as the main determinant of competitive advantage. The value perspective introduced concentrates on the existing interrelations among the different resource configurations creating value for customers [via products, services and networks], market positioning, and the competitive dynamical processes defining the barriers and interactions.
of firms with their competitors when creating and capturing economic value.

Similarly, the seventh chapter analyzes the creation of value at the corporate level, which takes mainly place through the combination of resources across different industries. In this case, corporate decisions are constrained in their value creation process by their effect on how the firm deals with resources, customers and competitors at the business level. The chapter provides an extensive literature review integrated within the main value theoretical ideas developed through the book. In particular, the creation of economic value via horizontal diversification, vertical integration, mergers and acquisition, and the partial integration process resulting from strategic alliances is thoroughly analyzed.

The eighth chapter studies the strategies followed by firms to create value combining resources across different countries as well as the advantages for value creation that hierarchies may have over other modes of entry with regard to resources, competitors and customers. Indeed, from a value approach perspective the presence of either operational efficiency [based on Teece’s internalization theory], knowledge transferability, market power or customer driven benefits suffices on its own for a MNE to create value as a collection of geographically dispersed units. In particular, the author emphasizes how this additive approach diverges from Dunning’s OLI multiplicative eclectic model.

Finally, the ninth chapter deals with the corporate social responsibility of firms that derives from the potential conflict between the creation of social value and the goal of firms to appropriate value. While mainstream approaches argue mainly in favour of profit maximization strategies for firms, the author defends a non-purely profit motive based on a dual standard for business and social activities. Following this dual approach would lead firms to produce as much social output as possible as long as costs do not outweigh the potential benefits in terms of, among others, firm legitimacy and reputation.

The main contributions of value analysis to the field of strategy as well as its implications and limitations are examined in the closing chapter. In particular, the core theoretical ideas developed through the book can be summarized as follows. First, in spite of the importance of value appropriation, it is the ability of a firm to create value by increasing customer benefits [through horizontal and vertical differentiation and product innovation] and reducing monetary and non-monetary customer costs what is remarked as the main determinant of its long run performance. Second, as the author states, “the comparative analysis of governance structure for transactions” [derived from the contracting and resource-based theories of the firm] “can be incorporated into the efficiency aspect of value analysis and expanded to any additional benefit or cost of moving firm boundaries around different resource combinations” (pg. 260).

The description presented above summarizes a book that delves into a wide array of branches from several theoretical disciplines including economics, strategy and management. In all cases, it provides the reader with a comprehensive summary of the main ideas developed in the corresponding literature and proposes a new and refreshing approach to all areas. Supporters of the different schools of thought under consideration have in their hands a new source of both ideas and controversies. Even detractors of the theoretical proposals introduced through the book will find in it an excellent road map through the main paradigms developed by all the interconnected disciplines that analyze the formation of firms, their performance and stability. Students will particularly benefit from the examples provided at the end of each chapter and the set of additional references described at the end of the book, both of which help illustrating and complementing the main ideas under consideration in each particular case. In conclusion, the book constitutes a coherent well structured and balanced first step into a new theoretical paradigm built to understand firms, their behaviour and evolution from a strategic perspective.
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