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COMPARING AND CONTRASTING THE "STRUCTURE-CONDUCT-PERFORMANCE" AND "RESOURCE-BASED VIEW" OF BUSINESS STRATEGY

Abstract

The strategy literature in the 1980s and 1990s has faced much debate as to whether firm-level or industry-level factors are determinative in shaping business profitability but little consensus has been achieved (cf. Barney 1991; Rumelt 1991; McGahan & Porter 1997). The inconclusive nature of this debate suggests that the research on interrelations between strategy, profitability, firms and industries display traces of simultaneity problem. Interactions between industry-level determinants and firm internal capabilities co-create strategy and shape profitability whereas related feedbacks have an effect on firm's resources and industry setting (cf. Henderson & Mitchell 1997).

This essay aims to explore those linkages by comparing and contrasting two foundational paradigms for the debate: the structure-conduct-performance (S-C-P) and resource-based view (RBV). As both emerged in relative isolation (Baden-Fuller 1995) and represent radically opposite streams of inside-out versus outside-in thinking about competitive process, the productive discussion calls for establishing the relevant unit of comparison, closely tied to the central question of business strategy. That is why, in the essay, both paradigms are compared with reference to their predictive power in determining sources of economic rents or, in the strategy language, competitive advantage.

It will be argued that neither alone nor collectively, the S-C-P and the RBV are sufficient in explaining competitive advantage determinants and that they offer more accurate explanations when enriched by premises coming from the institutional theory and the related concept of varieties of capitalism (VoC). The static and dynamic conceptualisations of both S-C-P and RBV along with critique with reference to the established comparison unit will be presented first. Contrasting both paradigms in the context of business strategy design will follow. The areas of mutual weaknesses, which can be supplemented by the notions coming from the institutional theory, will be presented at the end.

Keywords: business strategy, structure, conduct

1. S-C-P vs. business strategy

Originated from the industrial organisation (IO) economics, the S-C-P paradigm attempts to explain an industry level phenomenon (Mason,1939; Bain, 1956). Holding a strong assumption about the industry homogeneity, its basic proposition asserts that the structure of an industry, specifically the concentration level, the degree of product differentiation and the presence of barriers to entry, provide economic and technological determinants shaping key decisions undertaken by buyers and sellers (conduct), which in turn, determine the overall level of the industry profitability (Mason, 1939; Bain, 1956, Porter 1980, 1998). In this context, entry barriers in the forms of economies of scale, cost leadership and initial capital requirements, constitute the basic link between performance and structure (Bain, 1956). Conduct refers to decisions concerning i.a. pricing policy and R&D spending, whereas performance, is understood as economic efficiency of market operations.

Caves and Porter (1977) enabled this framework to serve business strategy by accommodating a certain degree of heterogeneity within via introduction of strategic groups – the concept proposed by Hunt (1972), who argued that firms possessing similar asset configurations can be clustered into homogeneous groups because they pursue similar competitive strategies. The resulting strategy proposition of the paradigm sees industries as composed of heterogeneous strategic groups, which are then composed of homogenous firms. Similarly to entry barriers protecting industry profitability, high performing strategic groups erect mobility barriers, which prevent intra-industry moves (Caves & Porter 1977).

One class of difficulties with S-C-P arise when it is applied to study sources of particular firms' rents, which actually is a key objective of the majority of business strategists. The use of inappropriate level of analysis occurring in both managerial and scientific contexts leads to i. a. research results or strategy recommendations being diverted from key firm-level analytical areas: single firm profitability determinants, core competencies or strategic intent. (McWilliams & Smart 1993). In the context of applied firm’s strategy, the concept of entry barriers is also limited as erecting a barrier is often costly and subject to free riding by others.

The main limitation of the S-C-P paradigm is, however, its static nature stemming from both the causal flow of conceptual elements and the microeconomic underpinning. S-C-P views firms as operating under equilibrium conditions what implies structural determinism and exogenous nature of an industry structure. The advancements in the research of dynamic systems questioned the viability of such static modelling, however (cf. Ghemawat, 1997). This called for another update of the S-C-P in the form of feedback loops signalling that the structure can be partially endogenous to firms’ actions (cf. Porter, 1991). Rents gained by industry players attract new entrants what changes industry structure. The increased level of rivalry affects conduct but the conduct-strategic behaviour of some players also affects the structure. The aggregated level of those interactions shapes the overall performance, which in turn, has an effect on structure as it stimulates economic progress incentivising technological development.

Furthermore, the unrealistic assumptions behind the static version of S-C-P that optimal conditions exist and can be sustained over time imply predictability of the total industry output. Consequently, industry concentration acts as a proxy for market share narrowing the managerial focus to either protecting or taking over customer bases (Mc Williams & Smart 1993). Developing strategy under the assumption of a dynamic environment, on the other hand, would provide incentives for creating new demand and stimulate the economy further. The efficiency paradigm, however, redefines S-C-P in this context by arguing that industry-level rents are contingent on excess profits of large and efficient players not on the level of concentration (McGee 1985).

Focused on industry-level, S-C-P sufficiently explains sources of the monopoly rents what makes it a much more relevant tool for regulators than for strategists. In fact, S-C-P has been widely used in antimonopoly regulation in the US since 1960s. By regarding firm as a black box and assuming that it will behave like any self-interested, utility maximising actor, the paradigm is, however, structurally inhibited to look inside the firm. Derived from microeconomic studies, black box-like conceptualisations implicitly presume that firms are able to adjust themselves to changing external contexts almost immediately, therefore, their resources can be efficiently used at all times. These presumptions are highly unrealistic, especially when contrasted with studies on organisational inertia and resource rigidity.

2. RBV in the strategy context

In contrast, the RBV emphasises the need for a match between the external market environment and internal capabilities. Moreover, it addresses a puzzle, the S-C-P could not resolve namely the relatively high degree of long-term intra-industry variance of profitability, as indicated by i.a. Rumelt’s (1984) empirical study. The RBV footprint can be attributed to Penrose (1959), who developed conceptual schema of a firm as a collection of resources. The paradigm was furthered in the mid-1980s by Wernerfelt (1984), Rumelt (1984) and Barney (1986) and became very popular conceptualisation of the roots of sustained competitive advantage (SCA). Despite having many formulations, RBV focuses primarily on the resources’ characteristics while explaining performance heterogeneity

The widely accepted formulation of RBV asserts that SCA is achieved via acquiring resources, which are valuable, rare, inimitable and non-substitutable (VRIN) and via building an organisation able to deploy them in the most efficient manner (Barney, 1991, 1994, 2002). Additionally, an important for strategy concept of *distinctive capabilities* was proposed by Kay (1993), who building on RBV, distinguished three types of capabilities (reputation, architecture of contracts and innovation potential) serving as a platform for competitive advantage. This formulation is especially important in the institutional context discussed later as it underlines the role of i.a. employment conditions in building firm's social capital. Unlike S-C-P highlighting entry and mobility barriers, RBV underlines the role of resource and capability barriers. Consequently, the theory was very successful in predicting sources of variance in outcomes of corporate diversification strategies (Teece 1982). However, likewise S-C-P, it initially failed to explain the dynamics of capability development and the roots of difference in firm’s abilities to learn and re-create skills.

Having the tendency to becoming obsolete especially in the presence of technological discontinuities, resources and capabilities can be viewed as stock depreciating with time. Depreciated capabilities become rigidities and inhibit competitive potential. There are however organisations possessing *dynamic capabilities* enabling constant renewal of the resource stock, as argued by Teece and Pisano (1994). Dynamic capabilities stem from combination of three factors: path-dependent asset positions, presence of higher-order routines and managerial commitments to long-term resource accumulation (ibid.). These predictions are in line with Dierickx’s and Cool’s (1989) dynamic overview of strategic resources. They describe them as causally ambiguous, subject to time compression diseconomy and developing from mass efficiency of interconnected stocks of assets. The dynamic perspective of RBV therefore holds-off the critique that SCA is not achievable (Pisano, 2015). While supplementing the RBV, it also partially bridges it with the S-C-P paradigm. What seems to be an entry barrier, may be instead viewed as a cumulatively developed resource (cf. McGee 1985). Sutton (1991) provides an example while looking at frozen food industry in the US. He found that a small number of initial entrants retained their market shares via strategically investing from the beginning in advertising. This erected an entry barrier and cumulatively developed strong brands.

Another critique of RBV refers to the assumption about bounded rationality, which is not consistent across the paradigm. RBV assumes that managers are rationally bounded and what partially shapes the SCA is the degree, to which they correctly identifies firm's strategic resources (Thomas & Pollock, 1999). Simultaneously, likewise S-C-P, it views markets via lenses of economic rationality (at the state of equilibrium) assuming that they will always make optimal choices, which ex vi termini cannot be better (cf. Bromiley & Rau, 2016). Making optimal choices requires, on the other hand, lack of bounded rationality what stays in contradiction with earlier assumption. Such a disjunction inhibits the normative function of RBV with regards to undertaking strategic decisions to achieve SCA.

3. Institutional contexts

Both S-C-P and RBV can be criticised for their ignorance towards institutions. None of them incorporates institutional contexts, in which businesses function, even if such contexts play a significant role. Hall's and Soskice's (2001) varieties of capitalism (VoC) thesis anticipates persistent differences in business strategies across capitalist regimes, which condition firms' boundaries and subsequently, their conduct.

For example the emergence of architectural dimension of distinctive capabilities (Kay, 1993) is facilitated by widespread relational contracting and long-term employment conditions typical for coordinated market economies (CMEs) and is inhibited by arms-length relations characteristic for liberal market economies (LME). The strong position labour unions in Germany or synergistic buyer-supplier relationships in Japan in contrast with the American employment model or the flexicurity Danish system can serve as relevant examples.

Additionally, S-C-P disregards institutions as it is anchored to 3rd order economising (Williamson, 2000), the layer of analysis, which by design treats institutions as given. Paradoxically, the paradigm is, however, derived from competitive patterns prevailing in the US in the 1960s, when economic expansion policies had a substantial effect on the overall level of rivarly (Dobbin & Dowd, 1997; Fligstein, 1990). RBV is also not immune to political and legal contexts as they effectively shape the characteristics of internal resources. Legally protected resources may be effectively inimitable in the context of well-functioning patent law and at the same time easy to imitiate in the lack of such context (Brouthers, 2008; Oliver 1997).

Innovation constitutes another area where differences between S-C-P and RBV in the institutional context are visible. The concept of dynamic capabilities, inscribed into RBV, implies constant renewal of resources and skills, which, in turn, facilitates adaptive change and incremental innovation. This type of innovation is a domain of firms functioning in CMEs, where institutions and firms are path-dependent and the system favours exploitation in organisational learning. On the other hand, risky, exploratory mode of learning characterises firms in LME, which are more strategically focused on radical innovations

(Witcher & Chau, 2012). This comes hand in hand with dynamic S-C-P view seeing technological discontinuities as endogenous feedbacks altering the position of the whole industry.

Conclusion

In conclusion, both S-C-P and RBV were developed to provide an explanation for one of the key questions in business strategy: why certain firms perform better than the others. Those paradigms trace sources of heterogeneity in profitability while starting from two opposite perspectives. Whereas S-C-P, explain industry level variance sketching causal influence of structure on firm’s decisions, which shape their performance, the RBV assumes atomistic perspectives looking at single firm’s resources and capabilities as sources of economic rents.

Both paradigms in their basic, static formulations are based on microeconomic concepts of perfect competition and recognises competitive advantage as the equilibrium condition, which is an unrealistic assumption. Both were therefore augmented to incorporate the dynamic perspective of a competitive process. Such formulations of SCP and RBV enhance each other but they still lacks institutional context to fully explain whole range of potential sources of competitive advantage. Additionally, while S-C-P states that firms are shaped to the large extent by external forces and RBV argues that firms can shape their environment, the institutional perspective acts as a moderator between the two showing the significance of institutional contexts in which interactions between firms, markets, governments and society happen.

The power of institutional analysis in such context lies in its ability to see motives for managerial behaviours much broader, as shaped by types of capitalism regimes or social obligations. Combined together, this federation of strategy paradigms sees strategic positioning within industry, resource capital and institutional capital as necessary to achieve sustainable competitive advantage.

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