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Institution and Resource • A Look at Start-Ups and Big Business

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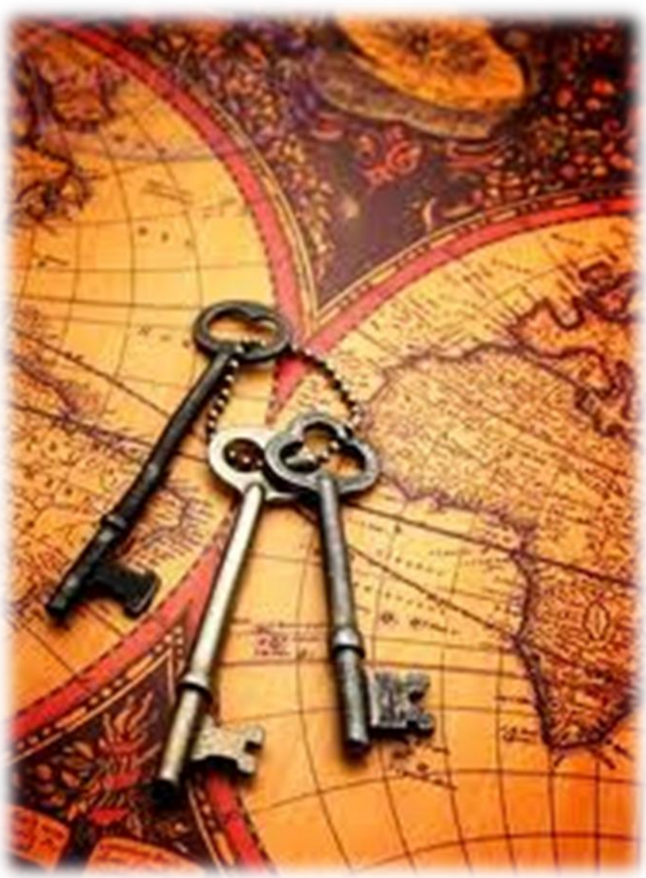
Introduction

What is it that we do in global business? A relentless interest in what determines the success and failure of firms around the globe serves to focus the energy of where we are to look for answers. Global business is fundamentally about not limiting yourself to your home country but treating the entire global economy as your potential playground (or battlefield.)



Some firms may be successful domestically but fail miserably when they venture abroad (Meredith, 2008). Other firms successfully translate their strengths from their home market to other countries. If you were to lead your firm's efforts to enter a particular foreign market, wouldn't you want to find out what drives the success and failure of other firms in that market? What determines the success and failure of firms around the globe? We can answer these questions as we consider them from two different core perspectives: an institution-based view and a resource-based view.

Institution-Based View

An institution-based view suggests that the success and failure of firms are enabled and constrained by institutions. By institutions, it is meant structures that define the rules of the game. Doing business around the glove requires intimate knowledge about both formal rules (such as laws) and informal rules (such as values) that govern competition in various countries. If you establish a firm in a given country, you will work within the institutional framework, or the formal and informal institutions that govern individual and firm behavior in that country (Skoll World Forum, 2009). Firms that do not do their homework and thus remain ignorant of the rules of the game in a certain country are not likely to emerge as winners.

Hong Kong's laws and regulations treat all foreign firms, whether from neighboring mainland China or far-away Chile, the same as they treat indigenous Hong Kong firms (Black, 2008). This equal treatment enhances the potential odds for the success of foreign firms. It is thus not surprising that Hong Kong attracts a lot of outside firms. Other rules of the game, which may discriminate against foreign firms, would undermine the chances for foreign entrants. India's recent attraction as a site for foreign investment in IT/BPO was only possible after it changed its FDI regulations from confrontational to accommodating. Prior to 1991, India's rules severely discriminated against foreign firms. As a result, few foreign firms bothered to show up there, and the few that did had a hard time. For example, in the 1970's, the Indian government demanded that Coca-Cola either hand over the recipe for its secret syrup, which it does not even share with the US government, or get out of India. Painfully, Coca-Cola chose to leave India. Its return to India since the 1990's speaks volumes about the changing rules of the game in India.

Informal institutions include cultures, ethics, and norms. These are not established by laws and regulations, yet they play an important part in shaping the success and failure of firms around the glove. For example, individualistic societies, particularly the English-speaking countries such as Australia, Britain, and the United States, tend to have a relatively higher level of entrepreneurship as reflected in the number of business start-ups. Why? Because the act of founding a new firm tends to deviate from the social norm of working for someone else, a norm that is not as strong in collectivistic societies. Conversely, collectivistic societies such as Japan often have a hard time fostering entrepreneurship. Most people there refuse to stick their neck out to find new businesses because it is contrary to the norm.

Overall an institution-based view suggests that institutions, or the formal and informal rules of the game, shed a great deal of light on what drives firm performance around the globe.

Resource-Based View

If we push the institution-based view to its logical extreme, then firm performance around the glove would be entirely determined by environment. The validity of this extreme version is certainly questionable.

The resource-based view has emerged to overcome this drawback. While the institution-based view primarily deals with the *external* environment, the resource-based view focuses on a firm's *internal* resources and capabilities (Think green products – materials, 2010). In harsh, unattractive environments, most firms either suffer or exit. However, a few superstars do thrive in these environments against all odds. For example, despite the former Soviet Union's obvious hostility toward the United States during the Cold War, PepsiCo began successfully operating in the former Soviet Union in the 1970's. Most retailers struggled in the current recession, and some have dropped out of business. But a small number of players, such as Wal-Mart, have been raking in the profits year after year. How can these firms succeed in highly unattractive and often hostile environments? A short answer is that PepsiCo and Wal-Mart must have certain valuable and unique *firm-specific* resources and capabilities that are not shared by competitors in the same environments.

Foreign firms have to overcome a liability of foreignness, which is the *inherent* disadvantage that foreign firms experience in host countries because of their non-native status. Just think about all the differences in regulations, languages, cultures, and norms. Against such significant odds, the primary weapon foreign firms employ is overwhelming resources and capabilities that not only offset the liability of foreignness but also offer them significant competitive advantage. Today many of us take it for granted that the Honda Civic is the best-selling car in the United States, Coca-Cola is the best-selling soft drink in Mexico, and Microsoft Word is the market-leading word processing software around the world. We really shouldn't. Why? Because it is *not* natural for these foreign firms to dominate non-native markets. These firms must possess some very rare and powerful firm-specific resources and capabilities that drive these remarkable success stories and are the envy of their rivals around the globe.

These case studies presented bellow will help us further differentiate what makes companies successful based on institutions and resources.

Kiva

Yawa Aziaka, a hardworking but uneducated entrepreneur in Togo (Africa), needs a loan to buy chickens and feed to expand her poultry business. She will repay the loan in 15 months. If you could change her life with a $25 loan, would you? Well, now you can. Kiva, a San Francisco – based start-up, is using technology to connect small – stakes lenders around the world with impoverished entrepreneurs in developing countries, a feat that's helping to change the nature of microfinance. Kiva's approach is straightforward. Entrepreneurs working with established local MFIs put their business plans, financing need, and photos on Kiva's website. Investors from affluent countries visit Kiva.org, choose which entrepreneurs to back, and then finance the loans. The organization, which incorporated as a nonprofit in November 2005, has already raised more than $2 million in loans from 26,000 lenders. The idea is simple, yet Kiva insiders acknowledge that it's only feasible with today's technology.

The idea for Kiva, which means "agreement" in Swahili, dates back to early 2004, when co-founder Jessica Flannery worked in East Africa through the Village Enterprise Fund, a San Carlos, California based nonprofit that provides business training, seed capital, and mentoring to people in that region. Inspired by her experience, Jessica and her husband, Matt Flannery, CEO and co-founder, tried to invest in microfinance ventures. But they learned they were priced out of the market. (The minimum investments for MFI funds are generally $50,000 or $100,000.) "We had seven businesspeople in Uganda we wanted to invest in, and we didn't find any organization that could help us do that," Matt Flannery says. So the Flannery's helped themselves. In March 2005, Matt created a website that featured the Ugandans' photos and stories. The couple then used the internet to solicit "shares" in those businesses from family and friends. The shares sold in one weekend. Kiva was born, but it was just a side project at first. Matt kept his regular job as a computer programmer until December 2005. Meanwhile, Jessica spent a year raising money and researching legal issues related to their venture.

Around the same time, Jeremy Frazao, a software architect, and his wife, Fiona Ramsey, an executive assistant at a real estate company, spent a year traveling. They arrived in Thailand just months after the catastrophic tsunami of December 2004. The couple sent e-mails to family and friends asking for contributions for local entrepreneurs in need. In two days, they raised more than $3,000 via their PayPal account, some of which came from strangers to whom their original message had been forwarded. “That’s what made my mind start spinning about the ability to raise money over the internet,” says Frazao. They returned to the United States in August 2005. Two months later, Frazao read about the nascent Kiva on a blog. “it just became clear to me that this is going to change everything,” he says. Frazao started helping Matt Flannery write code. Weeks turned into months, until Frazao finally became an officially paid employee in august 2006. Ramsey became Kiva’s community and operations manager.

Now Kiva’s mission is to draw others into microfinance. Visitors to Kiva’s site see that Juliet Igunbor in Nigeria needs $500 to expand her beauty salon. Francois Sebessi Akpatou in Togo is asking for $1,200 to grow his auto repair business. The entrepreneurs also say when they’ll pay back the loans. Website visitors who decide to invest in a venture contribute online, going through a checkout process much like they would at a retail site. So far, there has been a 100% payback rate, but most lenders reinvest their money (Matheson, 2010).

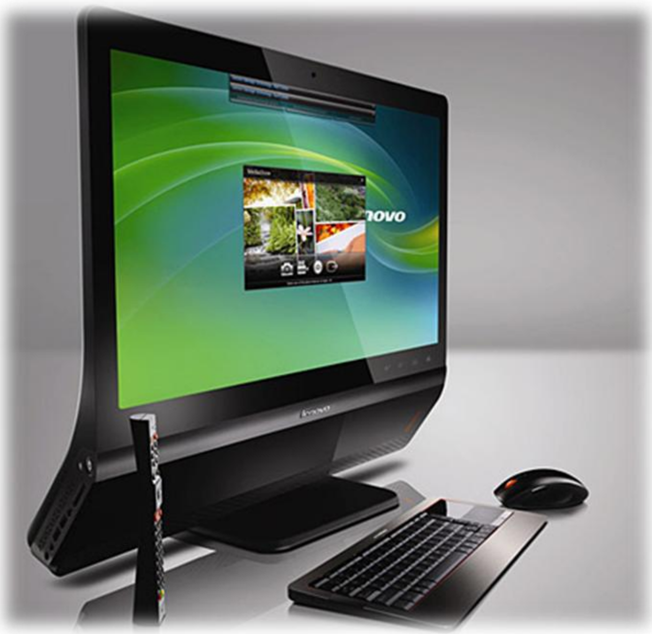
Kiva uses PayPal, a part of eBay Inc., to collect money from individual investors, PayPal reimburses Kiva for the transaction fees, essentially donating the service, which otherwise “far and away would be Kiva’s greatest expense,” Frazao says (Field Partners, 2010). Then Kiva wires the money overseas using San Francisco – based Wells Fargo & Co. PayPal is not available in many developing countries, making wire transfers the most efficient way of getting money there, Ramsey says. One of the biggest challenges is slow internet access in the developing world, Frazao says (Pratt, 2007). “The infrastructure in places like Uganda is so bad that it makes things almost impossible,” he says.

Back in the united state, Kiva staffers face additional challenges. Among the biggest has been scaling the technology fast enough to meet the site’s exploding popularity. A spike in the interest after PBS ran a story highlighting Kiva in October 2006 caused the organization’s servers to crash (Roodman, 2009). “The organic growth works for a while, but there’s a huge difference between organic, grass-roots architecture and a business-ready architecture,” Matt Flannery says (Flannery, 2009). In July 2006, Kiva finally acquired office space, two doors down from a Laundromat in San Francisco’s Mission District. Its budget increased from just over $125,000 in 2006 to $500,000 in 2007 alone, says COO Olana Khan (Kiva, 2008). Loftier goals include expanding the marketplace and bringing more lenders and borrowers together, says Matt Flannery. There’s also a plan to pay investors back with interest. “We’re just seeing the beginning,” Frazao says. “Kiva is about to get really big.”

Lenovo

When Lenovo announced in 2004 that it would acquire IBM’s Personal Computing Division (PCD) for $1.75 billion (Culpan, 2009)), most people outside of China, having never heard of Lenovo, were puzzled: IBM’s PCD was acquired by *what*? Lenovo was the leading PC maker in China, controlling 25% of the market. Yet, its annual sales were only $3 billion, and the $10 billion-a-year PCD alone was three times the size of Lenovo – IBM’s total sales would be $90 billion. This story of a start-up buying an icon thus grabbed global media attention.

In retrospect, the deal offered compelling strategic fit. Although IBM added the P (personal) in front of the C (computer) in the early 1980’s, PCD, under relentless pressure from Dell and HP, had been barely profitable in recent years (Lenovo, 2005). As IBM moved toward higher-value service, finding a buyer to off-load its PCD was natural.



Founded in Beijing in 1984 on a shoestring budget of $25000 as an investment from the Chinese Academy of Sciences (a government institute), Legend (as Lenovo had been called until 2003) was set up by 11 entrepreneurs. By 1994, Legend was trading on the Hong Kong Stock Exchange. Since its domestic market was under attack by Dell, HP, and IBM, Legend sought to go global. “If we just focus on China,” its CFO admitted, “we cannot generate returns for our shareholders.” Yet, the road to go global was arduous. The Legend brand had already been registered by other firms elsewhere, and Legend thus had to change its name. In 2003, Legend changed its name to Lenovo, taking the “Le” from legend and adding “novo,” the Latin word for “new,” to reflect its spirit of innovation.

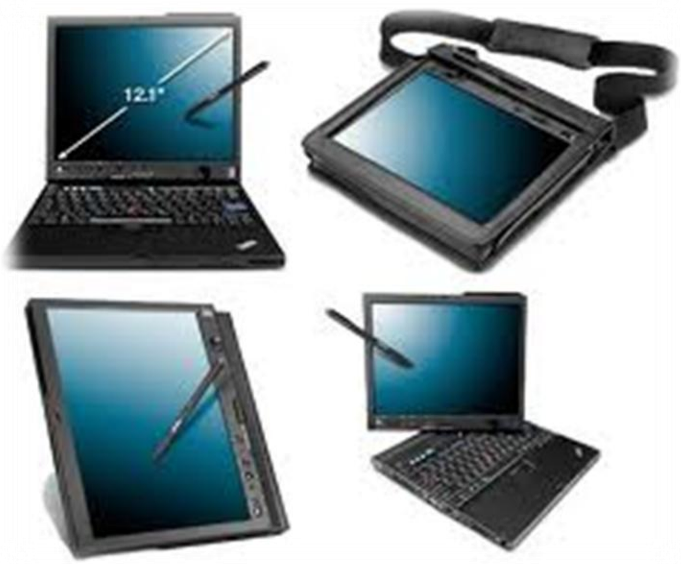
Now, how does one market a one-year-old brand that nobody knows? The solution was both ingenious and audacious: Acquire an icon like IBM (!). Obstacles were tremendous. From a resource-based standpoint, did Lenovo have what it takes to make a profit selling PCs when a venerable American technology company could not? This was the question that Lenovo’s board raised when examining the acquisition plan in April 2004. Given Lenovo’s lack of global experience (all of its executives were mainland Chinese), the answer, after three days of relentless questioning, was “No.” the board gave its blessing to the acquisition plan only when the acquisition team agreed not only to acquire the business but also to recruit top American executives.

IBM and Lenovo structured the deal as a part of the larger strategic alliance. IBM decided to keep a 13% stake in the combined company and contributed top IBMers, led by Steve Ward, former head of PCD, to help run it. In essence, IBM outsourced its PC business to Lenovo, and Lenovo outsourced much of its management and sales to IBM. Beyond PCs, Lenovo agreed to help IBM tackle the PC market in China and elsewhere.

From an institution-based standpoint, while the Chinese government was understandably supportive, the biggest hurdles were on the American side. The homeland security department and the FBI expressed national security concerns, and several congressmen threatened to torpedo the deal. In the end, the US government concluded that PC technology was mature with no real cutting-edge military use and approved the deal.

As a result, a $13 billion global PC Company, the new Lenovo, was born in may 2005. On third of the shares were owned by public shareholders, 28% by Legend Holdings (parent), 15% by the Chinese Academy of Sciences, and 13% by IBM. Headquartered in New York, Lenovo’s principal operations are based in Beijing and in Raleigh, North Carolina, near PCD’s former home. It runs R&D centers in China, Japan, and the United States, and operates facilities in Australia, Brazil, China, Hungary, India, Japan, Korea, Malaysia, Mexico, Slovakia, the United Kingdom, and the United State. In China, Lenovo now commands one third of the PC market. Worldwide, Lenovo is the third largest PC maker (behind Dell and HP) with 27,000 employees and a 5% market share.
Whether this deal will hold together also depends on organizational fit. On the surface,

differences in culture and language are evident. Ward, the first CEO of the merged firm, convinced chairman Yang Yuanqing to give up the idea of having dual headquarters in China and the United States. Ward argued that having world headquarters in the United States was an unambiguous signal of Lenovo's global outlook. Having an American CEO and a major US presence adds legitimacy to Lenovo. Instead of being a sideline to IBM, "PCs are our core business," proclaimed Yang. "We're focused on PCs to build our company as the strongest PC player in the world."



It is too early to tell whether this claim can materialize. Although American tech-buying experts have noted that "we can still buy [IBM] ThinkPads (pictured above) with confidence," politically sensitive buyers are not so sure. In 2005, GE dropped Lenovo and went with Dell. In 2006, the Us State Department changed the way it used some of its 14,000 PCs ordered from Lenovo, in fear of Chinese government snooping technology being tucked into machines. In short, despite its inheritance of the IBM grand, Lenovo faced tremendous liability of foreignness. Internally, the honeymoon was long over. Within a year, the board pushed Ward out, in part because he was too slow to cut costs (Lenovo, 2010). Since January 2006, the new CEO has been William Amelio, who formerly ran Dell's Asia operations. Amelio brought with him a team of former Dell colleagues. In essence, Lenovo was trying to blend two national cultures and, to add to the stress, three corporate ones (Lenovo, IBM, and Dell). The $13 billion giant only made $22 million in profits in 2006 (The Economic Times, 2010). But every step of the way, Lenovo is making history.

Daewoo

In 1984, General Motors (GM) and Daewoo formed a 50/50 joint venture (JV) called the Daewoo Motor Company. GM and Daewoo each contributed $100 million in equity. The JV would produce the Pontiac LeMans, which was based on GM's popular Opel Kadett model developed by GM's wholly owned German Subsidiary Opel. Commentators hailed the alliance as a brilliant outcome of a corporate marriage of German technology and Korean labor (whose cost was low at that time). As a win-win combination, GM would tackle the small car market in North America and eventually expand into Asia, while Daewoo would gain access to superior technology.

Unfortunately, the alliance was problematic. By the late 1980s, Korean workers at the JB launched a series of bitter strikes to demand better pay. Ultimately, the JV had to more than double their wages, wiping out the low cost advantage. Equally problematic was the poor quality of the LeMans. Electrical systems and brakes often failed. US sales plummeted to

37,000 vehicles in 1991, down 86% from the 1988 high.

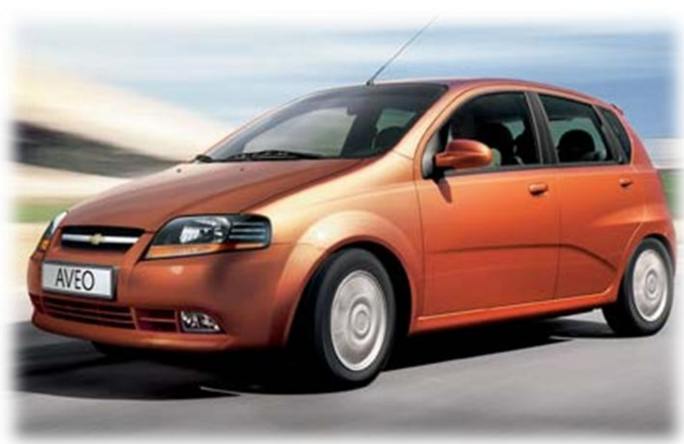
Daewoo, however, argued that the poor sales were primarily due not to the quality problems but to GM's poor marketing efforts that had not treated the LeMans as one of GM's own models. Further, Daewoo was deeply frustrated by BM's determination to block efforts to export the LeMans to Eastern Europe, which Daewoo saw as its ideal market. GM's reasoning was that Eastern Europe was Opel's territory.

Gradually, Daewoo secretly developed independent car models, and GM was unaware of these activities, at least initially (SEOUL, 2006). Once Daewoo launched competing car models, the troubles associated with this JV, long rumored by the media, became strikingly evident. The picture of an ideal couple with a perfect kid (the JV) was replaced by the image of a dysfunctional family in which everybody was pointing fingers at each other.

In 1992, GM and Daewoo divorced, with Daewoo buying out GM's equity for $170 million (S&T Daewoo, 2010). When GM exited the problematic JV, it was left without a manufacturing base in Korea. Daewoo on the other hand, embarked on an ambitious plan to built a dozen auto plants in Indonesia, Iran, Poland, the Ukraine, Vietnam, and Uzbekistan. In the process, Daewoo borrowed and astounding $20 billion, which led to its collapse during the 1997 Asian economic crisis (SEOUL, 1999).

In an interesting turn of events, GM and Daewoo joined up again. Despite its bankruptcy, Daewoo tried to avoid GM and preferred a takeover by Ford. But ford took a pass. Then GM entered the negotiations, and a new JV with Daewoo's Korean creditors, called GM Daewoo Auto and Technology Company, was eventually formed in 2001. The terms of this venture were quite different from the previous one. Instead of a 50/50 split, GM was now in the driver's seat, commanding a 67% stake (with a bargain-basement price of $400 million) – in essence, a GM acquisition in disguise (Schuman, 2008).

This time, GM fully integrated GM Daewoo into its global strategy, because this time GM had uncontested control. GM Daewoo now makes cars in South Korea and Vietnam and exports them to over 140 countries. One of the most decisive moves was to phase out the Daewoo brand (except in South Korea and Vietnam), because it had been tarnished by the quality problems and financial turbulence (Ramstad, 2006). GM has labeled a vast majority of cars built by GM Daewoo as Chevrolet, a brand that GM usually pitches as American. In the United States, Latin America, and Eastern Europe, the Gm Daewoo – built Chevrolet Aveo has become one of the best-selling compact cars, beating the Toyota Echo and the Hyundai excel. In addition to finished cars, GM Daewoo also makes kits to be assembled by local factories in China, Columbia, India, Thailand, and Venezuela, in three years, GM Daewoo's worldwide sales of cars and kits reached one million, up from 400,000 when GM took over (Upstreamonline.com, 2008). That makes GM Daewoo one of the best-performing units of the troubled Detroit automaker.



Outcomes for the Near Future

From a resource-based view, complex processes, strategies, and businesses such as these require strong management capabilities such as negotiating with local suppliers, undertaking internal verification, coordinating with NGOs for external verification, and disseminating such information to stakeholders. Such capabilities are valuable. But if competitors possess capabilities that can manage these processes, they become common resources.

Although valuable and rare resources may provide some competitive advantage, the advantage will only be temporary if competitors can imitate it. Resources must be not only valuable and rare but also hard to imitate in order to give firms a sustainable (not merely temporary) competitive advantage. The framework that companies must incorporate is called VRIO, Value Rarity Imitability and Organization, assessing whether they have captured a product and business model that embodies these principles. In order to access its abilities a company must ask questions such as: Do we have the *organizational* capabilities to do a good job in our industry? Is the firm organized to exploit its full potential? By asking these piercing questions VRIO will better shape a company's competitive advantage.

The institution-based view sheds considerable light on the gradual diffusion of a company's social responsibility and the strategic responses of companies. At the most fundamental level, regulatory pressures underpin *formal* institutions, whereas normative and cognitive pressures support *informal* institutions. The strategic response framework consists of *reactive, defensive, accommodative,* and *proactive* strategies; a reactive strategy would only respond to social responsibility when required by disaster or an outcry by the economic market. A defensive strategy focuses on regulatory compliance but with little actual commitment to social responsibility by top management. An accommodative strategy is one of moderate support from top managers, who may increasingly view social responsibility as a worthwhile endeavor. Lastly a proactive strategy anticipates social responsibility and endeavors to do more than is required.

What determines the success and failure of firms around the world? No doubt, social responsibility will increasingly become an important part of the answer. The best-performing firms are likely to be those that can integrate social responsibility into their core economic functions while addressing social and environmental concerns. Firm specific resources will also be at the forefront, building more humane, more inclusive, and fairer firms that not only generate wealth and develop economies but also respond to changing societal expectations. Only by concerning ourselves with these things can we develop good and lasting business around the world.

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