FUNDAMENTAL ISSUES IN STRATEGY: A COMMENT

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David Teece has highlighted the need for business to pay attention to geo-political issues because of the urgent need for "Western" business to meet the competitive challenge of China. He highlights three major weaknesses in current strategic management research – excessive concentration on the US business system, downplaying "non-market" strategies and ignoring culture in business decisions. Teece's analysis is too broad brush in that it ignores weaknesses in the Chinese system, imperfections in the American system and the parallels between the two. However, the focus on the wide-ranging competitive challenge from China is a welcome stimulus to improve research in strategic management.

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Fundamental Issues in Strategy

Teece's 2020 paper highlights three major weaknesses in current strategic management research and theorizing:

1) Excessive, almost exclusive, concentration on the US context and the US business system,
2) Concentration on the management of the firm and its decision making in a narrow context, ignoring or downplaying 'non market' strategies, the role of policy and business-government relationships,
3) An almost complete disregard of the importance of culture and cultural context in business decision making.

These criticisms come in the context of the rise of China as a formidable competitor, the vastly different nature of Chinese firms and the Chinese mode of competitiveness which has 'blind-sided' US and Western competitors.

Teece proposes a bi-furcated model of competition and suggests an analytical model based on oppositions where transparency versus opaqueness, the rule of law versus Government influence and political decision making, and freedom versus authoritarianism are the polar extremes. The US is implicitly at one extreme, China at the other.

(Figure 1)

Figure 1 around here.

This commentary focuses first on Teece's three-point diagnosis of the fundamental issues in strategy and then on his analysis of Chinese competition and its challenge to the "West", particularly to the USA and its economic system.

1) The importance of international competition – and competing international systems

Teece is clear and unequivocal in his criticism of strategic management theorizing in that it has not embraced international competition.

"…international competition is so ubiquitous that strategy scholars can no longer relegate this to the field of international business and expect to have even a semi-coherent field of their own." (Teece 2020).

Indeed Teece begins the paper "The field of strategic management has developed with an explicit assumption that market economies are structurally more or less similar." (Teece 2020). He could have added "to the USA".

One of the crucial contributions of international business research has been to show the importance of foreign direct investment (FDI) and its associated demonstration effects in transferring governance modes across borders, usually with positive effects for the host country in, for instance, reducing corruption or increasing transparency. (see for example Verbeke and Fariborzi 2019).

This model is now challenged, notably by China's Belt and Road Initiative (BRI) which is concerned inter alia with the inculcation of a Chinese model into host countries. The China model is indeed non-transparent and it does not differentiate between aid, trade, FDI, commercial and development bank loans, hard and soft loans. This 'bundling' of forms of international involvement and transfer makes it difficult to use conventional (western) analytical techniques to assess resource transfer and potential developmental effects (positive and negative).

2) Business-government relationships and the role of policy

It is arguable that the lack of attention paid to the policy environment of the corporation, and business-government relations generally in the strategic management literature, is at least partially a consequence of ignoring the international dimension. If all we discuss is the USA, then the policy environment is known and given, its dynamics to some extent predictable and its parameters known. Once we allow more than one national context, then policies become not known and fixed but variable, dynamic and possibly chaotic (Buckley 2018a). The 'rules of the game' are no longer given and knowable, but variable, differential and possible endogenous, if corporations can influence policy makers and state bodies. Moreover, if some corporations (local firms, state owned enterprises (SOEs)) can influence policy but outsiders cannot, this radically affects corporate strategy.

Non-market strategies

From a range of non-market strategies in the original writings (Boddewyn and Brewer 1994), Teece selects "the role of government as a factor of production, which firms must manage in their international value-added chains" (Teece 2019, p27 quoting Boddewyn and Brewer 1994:119).

Non-market strategies are an optional add-on in much strategic management writing. However, such strategies are a crucial part of the management of the external environment to which many companies (managers) aspire. The environment, by definition, is not under the control of an individual firm but it is possible to exercise influence, as the term "corporate diplomacy" (Henisz 2016) implies.

Management of global supply chains involves both market and non-market strategies. MNEs are able to fine-slice, orchestrate and manage disaggregated supply chains (Buckley 2009, 2019) in order to achieve flexibility, optimum location and control to manage dissemination of technology together with its protection. It is arguable that the Western system of flexible use of the market together with strategic internalization is better at managing global value chains than SOEs, with their inbuilt requirement for control, rigidity and lack of flexibility. Chinese companies notoriously use Chinese managers, Chinese technology and Chinese systems in their foreign ventures – a characteristic that has brought much criticism, opposition and indeed physical attacks on BRI ventures. Western firms are proving far more adaptable in managing complex international supply chains, than are their more monolithic Chinese competitors.

3) The importance of (national) culture

Cultural differences between nations (and between other types of groups, linguistic, professional, regional) make a difference in international business, not least in its underpinning of national institutions. Hofstede (1994 p1) defines culture as "the collective programming of the mind which distinguishes the members of one category of people from another". Culture is a shared system of meanings that affects how one group of people view the world, the self and the "other" (Moecklin 1995 pp 24-25). Culture is relative, therefore cultural difference is noted only when compared across cultures.

National differences between China and the USA become salient when the two cultures come into contact – with trade and FDI for example. It is obvious that US and Chinese citizens and managers are subject to differing collective programming. It is tempting, from the viewpoint of the USA, to define China, Chinese companies and the Chinese competitive system as "the other". (It is similarly tempting from the Chinese viewpoint to define China in contradistinction to the USA). This is to stereotype China as “different”, placing “the USA” on one end of a cultural spectrum (“open, democratic, competitive”) and China at the other extreme (closed, authoritarian, monolithic). It is clear that even characterizing as complex an entity as “the USA” as a single, uniform culture is profoundly misleading.

In analyzing cultural difference, nuance and context are everything (Stahl and Tung 2015). A much more forensic, granular approach to cultural differences and their impact on business is necessary (Chapman, Gajewska-De Mattos, Clegg and Buckley 2008).

The China Challenge

Teece uses the term ‘systemic competition’ to describe China. His position is too broad-brush and he misses the finer grained nature of China, Chinese business and the Chinese competitive threat to the West. Moreover, his black and white comparison ignores the faults and problems of the US (Western) system of capitalism and singularly misses the parallels between Chinese ‘systematic competition’ and what has been described as the ‘military-industrial complex’ in the US bringing together the military, corporate and political elements in society (Mills 1956). Consequently, much analytical traction and insight is lost. Certainly, China can be condemned as an authoritarian surveillance state, but social scientists should retain objectivity and not become partisan, whilst fully declaring their biases. In this respect my biases flow from my work on and engagement with China. When I began to work on China in the mid-1980s, China was unequivocally a less developed country. Since then its system has lifted over 700 million people out of poverty and has replaced grinding deprivation with hope for the future for over 1.4 billion citizens. However this has come at a cost. China has not become a participative democracy and, under its current leader, the one party state has become increasingly dominant and intrusive into the lives of private citizens. Its human rights record (particularly in Xingyang and Tibet) is appalling and it is perceived as an oppressive neighbor in the South China Sea which has frequently teetered on the edge of armed conflict. My attitude to China is therefore one of acute disappointment; admiration, but not love; hope, but pessimism as to the future political direction of a political and cultural colossus.

None of this should affect the dispassionate analysis of an alternative economic and political system.

Objectively, overt opposition to the 'Chinese system' can blind analysts to its weaknesses – its inefficiencies, hopelessly wasteful and dated management, short-term decision making and gross misallocation of resources. There is no 'presiding genius' in the Chinese system, real person or Artificial Intelligence (AI). Scale and monopoly do confer benefits but these often come at a high cost – the financial system in China ('financial repression') benefits some areas of the economy at a massive cost to others, to consumers and employers. The gross income inequalities may well be unsustainable even in a repressive system, and the crony capitalism (Pei 2016) facets of the system have produced a kleptocracy of huge proportions, inducing money laundering on a vast scale while producing the socially undesirable phenomenon of 'princelings'; the (paradoxical) Communist Party hereditary elite. As Jenner (1992 p36) says "All rights are only licenses held at the state's pleasure and revocable without notice." The human rights deficit in China's rise is significant. These disbenefits are easy to ignore if we begin by envisaging the Chinese system as an overwhelming juggernaut.

We must also question the sustainability of the current Chinese system. It relies substantially on transfers from the Chinese consumer to selected producers. Capital is made available to privileged companies at below market rates to enable outward investment (Buckley et al 2007, 2018). State owned enterprises, through the BRI meld economic and political objectives in their global strategies. Capital market imperfections in China are both are both "natural" and politically engineered to provide incentives for Chinese firms to compete abroad. The historical precedents for this type of targeted subsidy strategy are not portentous. European “national champions” have a poor record – in computers for example in Europe. The viability of the subsidy strategy can be questioned from both economic and political sustainability criteria

China is, at best, a middle income country. It is struggling to overcome the ‘middle income trap’ (Gill and Kharas 2007). Despite its success in lifting millions out of absolute poverty, the bulk of the population is below the median income of former Eastern European nations. Inequalities are the highest in the world and rising. The Chinese Communist Party has to create millions of new jobs each year to prevent the dangerous spectre of unemployment amongst new graduates. Its implicit bargain of “we will make you moderately rich as long as the legitimacy of the CPC is unchallenged” is beginning to fray at the edges. (The Hong Kong insurgency of 2019 is frightening to the CPC elite). There is vast unproductive capacity in State Owned Enterprises. This is not a model to emulate.

Nevertheless, Teece is right to be concerned about the competitive threat to Western firms (and, as a model, to Western advocates of state control). Concentration of power allows concentration of resources into strategic industries, often those with defence, social control and control over (personal, individual) data. Economies of scale allow formidable competitors to be built in these areas, often seen as the future commanding heights of the economy. The ability to sponsor or impose a single platform on the population, to discourage domestic and foreign competition and then to insist on participation in that platform is a powerful tool in the digital economy. Then, “standards” based on this platform can be imposed on the rest of the world as Chinese influence spreads, often linked to the “Belt and Road Initiative” or at least to its rhetoric.

This is not to deny the levels of fierce competition in China, the ability to innovate in a follower strategy and to amass sources of knowledge from a wide variety of sources to focus on the creation of a competitive advantage. State direction is combined with entrepreneur-led development to create formidable, and agile, competitors. Regulatory regimes are compliant with the perceived goals of the CPC.

The International Dimension (of strategy)

The three questions Teece poses (p4) [How do home country conditions shape the competitive advantage of multinationals? What determines the success and failure of global business firms in China? How do managers build and sustain competitive advantage when confronting rivals benefitting from state support?] are meat and drink to international business and management scholars who have wrestled with these questions for decades (see inter alia the pages of Journal of International Business Studies) . The first question has frequently been answered by variations on the theme that home country conditions are crucial in determining the strategy, trajectory, risk profile and management style of MNEs from that environment. Reams of papers have been written on the theme 'how to compete in China', and whilst the (increasing difficulty) of operating as a foreign firm in China have been widely documented, so too has successful operation. There is also a vast literature on competing with State Owned Enterprises and questioning of the simple view that State ownership always and everywhere confers an advantage.

The 'internationalization' of Porter's "diamond" (Porter 1994) by Rugman, Verbeke and others is but one example of uninational, ethnocentric models being made applicable to a globalized world (Rugman and Verbeke 1993).

The Chinese business model does represent a challenge to the governance models in use in Western economies. It is arguable that a key contribution of Western Multinational firms (through foreign direct investment) has been from the demonstration effects in the host countries of "good governance". This externality has led to copying of best practices by indigenous firms in the host countries and has upgraded efficiency, governance and welfare in many recipient economies.

Governance (good governance) is a spectrum. There is not a 'Western model' and a 'Chinese model' but gradations of governance practices. There is not 'one set of rules' but a web of interlocking, competing and conflicting national regulation, only poorly moderated by international rules (Buckley 2018a). There are important principles that could be used in harmonizing, improving and progressing rules that would be welfare enhancing but the political institutions and will are lacking and the heft of international policy making power is minimal compared to that of powerful nation states, notably China and the USA.

Models of National Competition

Teece's model of systems of national competition is illustrated in Figure 1. It is here represented as a spectrum with the USA and China as polar opposites, whereas Teece represents it as a system of oppositions.

We must question several elements of this analysis. First are transparency/opaqueness, "rule of law"/government influence, political freedom/authoritarianism actual opposites? Better perhaps to place them separately on three spectra rather than one conflation and treat them as "degrees of authoritarianism" etc. It is then possible to map not only China and the USA onto the spectrum, but all national economies. The extent to which these three factors map perfectly on to one another is debatable. China's degree of opaqueness is not necessarily equivalent to its degree of authoritarianism. Nuance is needed.

Just as China is not 100% on any of these measures, neither is USA 100% transparent, governed by the rule of law or possessing perfect political freedom.

In posing China and USA as oppositions, Teece ignores the interconnections and the interpretations of the "two systems" – in trade, FDI, portfolio investment, holding of debt, flows of students and tourists and knowledge flows (Mckinsey Global Institute 2019). There are over half a million foreign invested companies in China. Does this mutual exposure of China and the rest of the world not influence both?

Shades of grey, not black and white.

“Déjà vu all over again”

Teece’s characterization of the Chinese competitive threat has echoes of the “Japanese challenge” of the 1980s and 1990. Looking back on that literature, Japan was regarded as an unequal trader and manipulator of standard capitalistic rules. Its role as a “developmental state” was defined as contrasting with “the West” on the lines of Huntington’s (1996) clash of civilizations. Japan was seen as collective, long term and as a coordinated single entity with powerful business-government relationships that led to its characterization as “Japan Inc” (e.g. Vogel 1979). As Japan ‘normalized’, its trade surplus with the US and the rest of the West declining, its market (albeit reluctantly and gradually) opening and its “otherness” defined away, its economy and competitive system were more carefully dissected. Whilst differences did, and still do, exist, they are explicable by conventional analysis. Ironically, now “Japanese” governance elements such as linking banks to corporate entities, government guidance and “lifetime employment” are seen as competitive disadvantages!

It is arguable that the security threat, hard power and illegal subterfuge (such as IPR violations) are much more substantial in the case of China but we should remind ourselves that we cried ‘wolf’ once before and carefully reconsider the parallel case of Japan.

However, the parallel is not exact. There are systematic differences in the challenges posed by Japan in the 1980s and China now. The geo-political ambitions of China take the required analysis into the world of geo-politics. The challenge of China is not only an economic and strategic firm-level issue, it is also a political challenge that business executives and analysts cannot ignore.

From this perspective, the appropriate comparator is the challenge of the Soviet Union to “the West” following the end of World War II until the collapse of its empire in 1989. This was truly a geo-political and ideological challenge to the West and its values. The twist, as Teece points out, is that

Western firms were only peripherally engaged with the Soviet economy and Soviet thinking. In contrast, Western firms are deeply embedded in the Chinese economy through direct investment and the deep engagement of Chinese firms in Western global value chains. A large swathe of Western industry has traded short term gains of involvement with China for strategic global positions. The threat here is to the integrity of Western multinationals and their independent (competitive) decision making.

It is arguable that China represents a "Soviet Union plus Japan" competitive challenge versus the US (the West). Such a threat requires careful unpacking and a nuanced response.

Summary

David Teece has raised some profound, indeed existential issues about the future of strategic management research. However, a more nuanced approach is necessary if strategic management is to make further progress as a social science. The simple juxtaposition, and opposition of "the Chinese system" versus "the US system" simply will not bear the complexities of analysis that are required. Examining the mote in our own eye – the faults of "the Western system" – is a key element of moving forward as is a more forensic dissection of the Chinese system. [i]

Teece's bifurcation represents simply two points on a continuum. That continuum is variously: openness, rule of law, authoritarianism, independence of business and several other indicators. International business scholars have for years been placing nations on continua, often denominated in terms of "culture" (Hofstede 1991), the GLOBE project (House et al 2002)). Teece is signaling the need for closer integration of cultural/national culture measures with business strategy and this is indeed a considerable part of the international business agenda.

What is to be done?

The China challenge forced many commentators to question the current Western (business) system. Some pessimistically suggest that the way forward is to adopt the (perceived) successful Chinese system. This is a chimera. This paper, and any serious study of China, shows that Chinese culture and history uniquely affect the Chinese social, political, economic and business system. This is not replicable outside China. A lesser variant of this argument is to adopt the seemingly central aspect of the Chinese system – authoritarianism ("a strong leader"). Again, this is inimical to Western tradition and is against the perceived wishes of a majority of the Western population. State direction, then? State control and direction do not have a good track record of success in Western democracies.

A better approach is to improve the existing Western business system. This means building on success after all, no business system has such a track record of success (over a 200 year period).

Policies, strategies and consensus movements that could improve the Western system include:-

1) Policies to reduce inequalities (these will also increase social cohesion, productivity and welfare).
2) Improvements in individual security including employment rights and pensions, welfare payments and improved 'safety nets' (such policies improve long-termism by reducing short term risk minimizing and opportunistic behavior).
3) Rational economic policies to encourage innovation, entrepreneurship, cooperation and intellectual property right security.
4) International coordination of policies and strengthening rules - based investment and trading systems.

What is needed is not a poor imitation of an authoritarian system but democracy 2.0; an improved, secure, property owning, outward looking, free, equal and prosperous society. Can China match that?

Business has a massive role to play in this potential transformation by adopting a stakeholder rather than purely shareholder view (Buckley 2019b) and engaging in "burdensome responsibility" to achieve societal goals (Buckley 2019a). Improved remuneration packages, particularly at the lower end of the scale, security of employment (in return for productivity improvements), flexibility in the workplace, attention to superordinate goals and genuine societal commitment are the attributes (dynamic capabilities?) necessary to revitalize both the business contribution to society and the reorientation of the strategic management field.

Teece's call to arms to strategy scholars has immense force in its recognition that "no business is an island". Attention to geo-political issues is an essential element of modern business – and to its analysis.

Figure 1: Teece's implicit "Systems of National Competition"

Transparency	Opaqueness
Rule of Law	Government Influence
Political Freedom	Authoritarianism
USA	"China's Socialist Market Economy"

Source: Author's interpretation of Teece (2020)

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[i] As a minor illustration of how “differences” can be exaggerated across cultures: at a recent seminar on “Guanxi” – felt to be a uniquely Chinese system of network relationships based on connections and mutual favours – a British businessman said “AH, now I see, it’s the old school tie system”!