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Dynamic capability in a small global factory

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ABSTRACT

In order to balance their local and global operations optimally, SMEs are moving toward a 'global factory' type of organizational form, meaning a differentiated network of activities held together through the control of key assets and flows of knowledge, and coordinated by a focal firm. Managing such a network requires a specific dynamic capability comprising, according to our study, cognitive, managerial, and organizational capabilities. Cognitive capabilities – cultural awareness, entrepreneurial orientation, and a global mindset – are the basis for a global factory because they are the source for opportunity recognition and exploitation, and are therefore crucial. The focal firm's organizational flexibility and absorptive capacity, as well as managerial capabilities in the areas of interface competence and analytical capability, are needed in the steering of a small global factory, the success of which depends on the nurturing of these assets.

1. Introduction

Following developments in technologies and markets, for instance, companies have begun building new kinds of organizational structures. An intriguing trend is the emergence of 'the global factory', defined here as a globally dispersed value network of goal-disparate organizations, which jointly generate the activities traditionally governed within a single company (Buckley, 2009a; Buckley & Ghauri, 2004; cf. Mudambi, 2008). Although the global factory has thus far been discussed only in the context of large corporations (Buckley, 2011), there are also a growing number of small and medium-sized enterprises (SMEs) that have built a similar governance structure as global presence has become a necessity for them (Gupta & Westney, 2003). This study is the first attempt to explore SMEs in this context. A small global factory is not a legal entity, rather a differentiated network coordinated by an SME (cf. Buckley, 2009a, 2011) held together through the control of key assets, and flows of knowledge and intermediate products (cf. Buckley, 2007, 2009b). The global-factory structure results from the search for an optimal ownership and location solution for maximizing value-adding activities (Buckley, 2009b).

Previous research recognizes that ownership advantages have been leveraged against geographically spread structures (Dunning, 1988; Kogut & Zander, 1993), and that location-specific advantages are focal in foreign expansion, particularly when combined with firm-specific advantages (Dunning, 1988; Erramilli, Agarwal, & Kim, 1997). Nonetheless, recent studies have focused on location dynamics[1] as companies increasingly shift between locations in the search for efficiency (Mudambi & Venzin, 2010). Researchers have explained this with reference to several theories, including the eclectic paradigm

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[1] One area in particular has dominated the discussion on the location of value-adding activities in recent decades: China has transformed from one of the world's most isolated and backward economies into its fastest growing and most forceful (Fang, Zhao, & Worm, 2008). Combined with the increasing tendency for firms to separate and relocate various stages of production, this has led to a boom in locating manufacturing and service activities in China and India (Buckley, 2007).

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(Dunning, 2001), linkage economies (Mudambi, 2008), and the flying-geese paradigm (Kálmán, 2004). Finding an appropriate governance structure and managing it effectively is 'a must' in today's global business environment, and thus lies at the heart of international business theory.

The emergence of global factories challenges existing theories in many respects. It requires a shift of focus from a single company toward inter-organizational, global value networks. Although the literature on multinational enterprises (MNEs) addresses geographical dispersion and conflicting goals in networked organizations (Ghoshal & Bartlett, 1990), and acknowledges the existence of 'the embedded multinational' (Forsgren, Holm, & Johanson, 2005), the governance mechanisms in the organizations concerned are largely based on ownership. This is quite surprising given Hymer's claim in his seminal works on foreign direct investment that ownership is not necessary for effective asset control (Strange & Newton, 2006).

Therefore, existing international business theories only partially explain the novel phenomenon. Business models of the global factory are based on a very different logic: partnership instead of ownership. Thus, controlling and integrating critical resources is decisive (Buckley, 2011; Mudambi & Venzin, 2010). In order to enjoy the benefits of outsourcing the firm's activities to independent partner firms, the consequential virtual organization needs to be motivated, monitored, and properly managed. Although something is known about how MNEs manage their alliances and partnerships, understanding the phenomenon from the SME perspective is in a nascent state. We believe it is of importance to make a distinction between small and larger established global factories. Most notably SMEs are different as they lack necessary resources (e.g., Buckley, 1989) and therefore, risking specific and non-redeployable investments might endanger future growth and even the survival of these firms (Sapienza, Autio, George, & Zahra, 2006). Thus, even if it might be rational to internalize activities (Erramilli & Rao, 1993) the constraints in the resource-base make it necessary for the smaller firms to look for alternative and non-ownership based governance structures. Based on the current knowledge on global factories, this kind of structure may suit the SME, which is also under pressure to be simultaneously globally efficient and locally responsive. Yet, given the limited empirical evidence, no definite conclusions can be drawn.

It is obvious that a globally dispersed value network creates considerable managerial challenges for SMEs (cf. Mudambi & Venzin, 2010). SMEs with inexperienced managers inevitably lack the legal, social, and political discernment to operate abroad (Buckley, 1989). Consequently, many SME managers find it difficult to manage and expand the firms they have created, and only few of them wish to do so (Nummela, Puumalainen, & Saarenketo, 2005). In many cases this would require the development of a new *dynamic capability* (e.g., Teece, 2007; cf. Mudambi & Venzin, 2010). However, little is known about the kind of capability required for the successful management of a small global factory, for two main reasons. First, previous research on global factories has concentrated on the location and ownership strategies of MNEs, and second, thus far researchers have shown little interest in the obligations that the changed governance structure imposes on management. Therefore, this study addresses the following question: Which factors constitute the dynamic capability needed for managing a small global factory?

The main contribution of the study is to the emerging research on the global factory. Most importantly, we propose that the novel governance structure is relevant and applicable to SMEs. Due to the differences between SMEs and MNEs, it is important to explore also the SME context to gain better understanding of the phenomenon. We also extend the use of the concept by applying an inside-out as opposed to the prevailing outside-in approach. This means that we examine the global factory from perspective internal to the firm. We collect primary empirical data within the small global factory and analyze it from the perspective of the focal SME. This is a significant deviation from earlier research, much of which is based on conceptual discussion or secondary data, and it enables the examination of the management factors that are important in the SME context, whereas previous research has maintained a distance and has not gone into the organization. The value of our approach is in gaining more holistic understanding of the global factory governance structure.

Secondly, given that the creation of a global factory governance structure can be considered an entrepreneurial discovery (cf. Shane & Venkataraman, 2000), the study advances the theory of international entrepreneurship (IE). This is still a young research field (Jones, Coviello, & Tang, 2011), and studies examining internationally entrepreneurial firms with highly networked and globally dispersed organizations are rare. The few exceptions focus on micromultinationals,[2] which are clearly not global factories as defined in this study. On the other hand, the period of post-entry internationalization has aroused little interest in IE research (Morgan-Thomas & Jones, 2009; Prashantham & Young, 2011), and we believe our study brings out issues of relevance for the growth of international entrepreneurial companies.

2. The small global factory and dynamic capabilities

2.1. The role of dynamic capabilities in a small global factory

Grunwald and Flamm (1985) introduced the concept of the 'global factory', and more recently Buckley and Ghauri (2004) applied it to the context of international business, where it refers to the governance structure of MNEs that have developed from single conglomerates to globally dispersed networks of goal-disparate organizations (Buckley, 2009a, 2009b, 2010;

[2] Micromultinationals are defined as vertically integrated small firms that share the traditional governance structure of large, multinational enterprises (Dimitratos, Johnson, Slow, & Young, 2003).