MODELS, PHILOSOPHIES AND INSTITUTIONAL CONFIGURATION[1]

"... it is striking how matters of money, power, and initiative appear quite in the shadows in books and studies on business management, oblivious to the fact that they are critical to the job of governing."

Antonio Valero and José Luis Lucas[2]

One of the most unique features of Valero and Lucas' Business Policy is the recognition of institutional configuration as a key aspect of corporate governance. This idea allows for a deeper and better understanding of the topics of entrepreneurship, power, and money, the three cornerstones of a company's good progress and continuity. The success of Business Policy lies in the fact that treating these three elements jointly provides a better understanding of how they are interrelated and of their common origin when they are most often treated separately, with a subsequent loss of perspective[3].

For the past two decades, the literature on business administration was dominated by business strategy. Why has institutional configuration not received similar attention? One possible explanation is the great conceptual development that strategy models have experienced in recent years as a result of the application of economic theory to this area of corporate governance. This higher conceptualization of business topics was appealing to many professors who began to disseminate it in business schools, and it was also well received by consultants and managers.

The emergence of these new models had the effect of concentrating much attention on business strategy, often at the price of postponing equally important issues that lacked the advantage of such a structured and applicable conceptual system.

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[1] Technical Note produced by the Research Division of Instituto Internacional San Telmo, Spain. Prepared by Professor Juan Antonio Palacios Raufast.

[2] Valero and Lucas [2005], 123.

[3] The Business Policy model is presented in Valero and Lucas [2005], sixth edition of the book originally published in 1991. Ginebra [2000] and Lucas [2004] offer additional comments. Lucas et al. [2005] include several works on institutional configuration.

As long as institutional configuration fails to develop such system, it will fail to reach the prominent place it deserves in corporate governance, both in publications and business schools courses. The following is a brief review of the literature and current state of business administration, which will give way, at the end of the work, to some considerations on the possibility of a more in-depth conceptual development of institutional configuration.

THE ECONOMIC MODEL

Economic theory has always found fertile soil in the activity of companies, having reaped its most concrete results in the last decades in finance, business strategy, and, lastly, organizational design.

Recent Evolution

Towards the end of the sixties, a group of economists created a new theory that made outstanding contributions to the knowledge of financial markets and business finances. These ideas were immediately included in lessons in business schools, and somewhat later incorporated into the real world of financiers and market players. The new theory turned out to be a very useful tool to organize ideas, reflect from a fresh perspective, and establish some basic principles, although this is not to say that their conclusions, based on very idealized assumptions, should be applied literally in practice. The challenge of finance professors is to recognize this limitation and take it into account in their research and teaching, always aware of how these problems are solved in the real world. [4]

If the seventies were the years of new financial ideas, the eighties became a triumphal procession of the contributions to *business strategy*. The process was quite similar to that of finances a decade earlier, although this time, it was the economic research on industrial organization that began to be effectively applied and disseminated by business schools and consultants. Noteworthy in this endeavor was Michael Porter, a disciple of Professor Andrews and a member of his team of professors at Harvard[5]. Porter used economic theory to develop some of Andrews group's ideas, producing a business analysis scheme. The gist of his proposal is that competition and the prospects of business profit are determined by factors such as how easy or difficult it is for new competitors to enter the business, the strength and power of suppliers and customers, and how likely are other sectors to develop substitute products. In this framework, companies can improve their situation either by reducing costs or by differentiating their products so as to sell at higher prices.

[4] A broader discussion on this matter can be found in Palacios [2003].

[5] This team's ideas, which were developed in their courses on business policy, are gathered in Andrews [1987], the third edition, originally published in 1971. Porter's concept of business strategy can be further explored in Porter [1980] and [1985]. An interesting contribution to these models from the field of consulting is that of Bruce Henderson, founder of the Boston Consulting Group. Some of his articles can be read in Stern and Stalk [1998].

The immediate success of these ideas and their widespread dissemination pushed other areas of corporate governance into the background. It can be said without exaggeration that some people reduced business management to the mere design of a business strategy, at times completed with a few considerations on its practical application. Despite this undesirable consequence, this contribution meant visible progress in the knowledge of the nature of business nonetheless.

This dominant position of the strategy has continued to this day when there is a new impulse, this time oriented to the organizational design. Once again, the foundations of this initiative were laid by the recent economic research of a group of economists whose contribution was distinguished with several Nobel prizes, as was the case with finance. The combination of new ideas on organizational design and those already known about strategy now allows for a broader and more complete conceptual model that could start a new period in which corporate governance will again favor these areas at the expense of other less structured ones. The following section summarizes the basic approach of this new economic model.

The state of the art[6]

The traditional sequence to approach the organizational design from a economic standpoint is: 1) to consider the economic, legal, social, and technological environment as a piece of data, 2) formulate a business strategy, and 3) design the organization to execute this strategy. This sequence is in line with the sentence coined by Chandler [1962] that: *structure follows strategy*.

The starting point of this whole process usually is the identification of a business opportunity that may arise due to an imperfection of the market or an unmet need. The next step is the formulation of a strategy to exploit this opportunity containing the following elements:

1. formulation of the company's competitive advantage,
2. explanation of how this advantage will materialize in practice,
3. definition of the business scope, its products and services, activities undertaken, location, and technology, and
4. a goal against which we can measure the company's progress.

According to this system then, the organization of the company appears as a means to undertake a series of activities to implement the strategy. Although organizations can become very complex, they can be conceptually broken down into people and a set of organizational variables: architecture, routines, and culture, forming the acronym PARC. The architecture is tantamount to the organization chart with the structure of commissions and jobs and hierarchical relationships. It also covers all financial aspects, company ownership, and governance structure.

[6] The content of this section is based on a book by John Roberts [2004] that sets forth a good summary of the recent contributions of economic theory to business management.