

## **Taking Business Seriously: Introduction to Special Issue**

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Two broad themes inspire this special issue of the *International Journal of Business*: First, that business seriously *under*-performs and, second, that scientific research makes it possible to practice evidence-based management and improve business performance.

Consider modern business education and business practice. Three innovations at the Harvard Business School have been widely adopted. In business education, the “case method,” formalized as the main HBS teaching technique about 1920 by Dean Wallace Donham, was adapted from education in common law (Donham, 1922). It builds on precedent and consistency rather than on empirical evidence to develop scientific theory. The Harvard case method conveys an aura of business reality, but whether it contributes to understanding and effective practice is in question (Contardo and Wensley, 2004). That “most of the School’s intellectual activity focused on the task of case research” appears not to have enhanced HBS research impact relative to other business schools (Cruikshank, 1987: 280; cf. Armstrong and Sperry, 1994; Fogg 2007: A11). Quantitative case analysis, an alternative approach to business reality, builds on scientific suggestions by Summer, Bettis, Duhaime, Grant, Hambrick, Snow, and Zeithaml (1990), and is presented here by Franke, Mento, Prumo, and Edlund (2007).

A second innovation was managerial--the “human relations” movement of the 1930s and 1940s which was ostensibly but not actually related to productivity experiments by managers at the Hawthorne Plant of the Western Electric Company (Jones, 1992; Yorks and Whitsett, 1985). Elton Mayo, a business professor at Harvard educated in philosophy, had as a young man in Australia observed and objected to influence wielded by workers during a general strike (Mayo, 1919). In line with this and his expressed antipathy to democracy (Mayo, 1933), his “human relations” philosophy supported strong, paternalistic direction of workers by managers (Bendix and Fisher, 1949; O’Connor, 1999). In the United States, the human relations movement and related human resources management seem to have discouraged the more open and effective corporate governance procedures which benefit European Union economies (Franke, 1997). Management building on science rather than on unsupported philosophy is applied here to strategy formulation by Grant (2007), strategic leadership by Bass (2007b), decision making regarding investment by Franke and Miller (2007), and to legal and effective personnel practice by Barrett (2007).

A third innovation over the past several decades was the shifting of strategic goals away from own performance (e.g., corporate profitability) toward viewing performance relative to others (e.g., as market share). It is based on ideas of Michael Porter, an HBS strategy professor whose seminal “competitive strategy” publications

(Porter, 1979; 1980) are preeminent in strategic management research (Ramos-Rodríguez and Ruíz-Navarro, 2004) and have more than 3,000 journal citations (Institute for Scientific Information, 2006). Porter's philosophy has been generally accepted, perhaps explaining lack of examination of performance impact from its radical goal displacement except by Armstrong and Collopy (1996). Effects on education and performance are appraised here by Armstrong and Green (2007).

That these innovations became "normal science" paradigms (Kuhn, 1962/1996; Fuller, 2004) helps answer the question (after economists Thorstein Veblen, 1898/1998, and Martin Baily, 1986): Why does business management *not* seem to be accumulating scientific knowledge and to be growing in proficiency? We examine problems that result from using anecdotal rather than empirical information, from untested theories, common sense and political correctness, and from goal diversion. By examining performance empirically, the articles here aspire to be "taking business seriously."

**A.** In his "Advances and Challenges in Strategic Management," John Grant (see Summer et al., *Journal of Management*, 1990) builds on his work and that of colleagues to describe post-World War II development of strategic management and some of the challenges that it faces. He considers the strategic context of business, including current and long term environmental problems.

**B.** In his "Executive and Strategic Leadership," Bernard Bass, responsible for many developments in leadership, organizational psychology, and international management and for the *Handbook of Leadership* (2007a), transcends superficial assumptions in this field. He describes multiple dimensions of strategic leadership and provides examples of effective leaders.

**C.** In their "Capital Investment *versus* Utilization in Business Performance and Economic Growth," Richard Franke and John Miller build on Herbert Simon (1979) to evaluate the "economic man" assumption that managerial expertise and self-interest lead to optimal decision-making. In the key area of capital, they show that greater rates of investment have not led to more economic growth, probably due to inattention to labor and capital utilization as suggested by Gordon Winston (1974).

**D.** In his "Legal and Logical Limitations in Applying Social Sciences to Business," Gerald Barrett builds on his early work in *Personnel Psychology* (1972) to describe political correctness and derivative fads and legal misinterpretations as barriers to using valid scientific procedures in personnel decisions. He suggests science-based rather than politically-correct personnel practice for effective business performance.

**E.** In their "Competitor-oriented Objectives: The Myth of Market Share," Scott Armstrong and Kesten Green build on work by Armstrong and Collopy (*Journal of Marketing Research*, 1996) to demonstrate that focus on competitive rather than own performance diminishes success for corporations and for student groups. Corporate profitability is shown to be better than market share as a business performance criterion.

**F.** In their "General Electric Performance over a Half Century: Evaluation of Leadership and Other Strategic Factors by Quantitative Case Analysis," Richard

Franke, Anthony Mento, Steve Prumo, and Timothy Edlund adapt econometric methods to analyze corporate performance. Factors in the competitive and legal environments, corporate culture and leadership, labor relations, and the economic environment explain most of the year by year variation in GE's real profitability and market value—knowledge which can be used to improve future performance.

### I. DOMAINS, PROBLEMS, AND OPPORTUNITIES

Business disciplines, including accounting, statistics, economics, finance, management, and marketing, provide a wealth of ideas and techniques. However, for practice in business--as in other scientifically-based professional fields such as engineering and medicine--there are gaps of measurement and understanding in each sub-field, and it is important to integrate information from a variety of disciplines. The applied field of strategic management responded to this challenge over the past quarter century. It is goal-oriented rather than elaborating particular scientific phenomena or methods. It focuses on the business criteria of return on investment, sales growth and market share, stock market value, and survival. Management and strategic management in particular are opportunistic--using whatever can be helpful, including:

- A. Standard accounting procedures to measure performance, as well as to provide key indicators such as liquidity and capital intensity.
- B. Economic theories such as neoclassical investment *versus* a capital-sparing utilization orientation.
- C. Technological changes influencing processes and products as well as marketing.
- D. Management approaches that influence business, including:
  1. Entrepreneurial corporate culture high in achievement motivation, individualism, flexibility, inventiveness, and innovation.
  2. Managerial and hierarchical corporate culture of control, high power and low affiliation motivation, high power distance, high long-term orientation.
  3. Stakeholder relations, including governance, unions, strikes, cooperation.
  4. Categorical policy changes including "restructuring," acquisitions, mergers, spin-offs.
- E. Economic environment--in particular national economic growth and inflation.
- F. Political environment (political party of national government) and regulations inhibiting economic freedom and labor market flexibility.
- G. Strategic management that views the firm as a whole.
- H. Statistical modeling to explain corporate performance differences and make suggestions--especially time-series stepwise multiple regression of ROI (or of sales growth or market value) year by year over decades, as in production models for nations by central bankers and other macroeconomists.
- I. Comparative analysis: Cross-sectional and parallel time-series: Comparisons of firms, with own industry and other industries, with own nation and other nations.
- J. Empirically-based decision making: Use of high-quality data and theories, analytical procedures, and alternative goals to direct the firm strategically.

Business education responded in the 1960s and 1970s to suggestions from the Ford Foundation and Carnegie Commission (Gordon and Howell, 1959; Pierson, 1959) that business schools apply the key disciplines of behavioral sciences and economics using tools from statistics and computer science, integrating them with other business disciplines in business policy courses. Potentials unleashed by this intellectual and quantitative integration are seen in the management and strategic management revolutions engineered at Carnegie Tech and Purdue by James March, Herbert Simon, Dan Schendel, and colleagues (March and Simon, 1958; Schendel and Hofer, 1979).

However it appears that business organizations, which produce most of the world's economic product and much of its employment, still are not taken seriously enough. Standard and managerial accounting follow professional and legal dictates, ignoring changing currency values in one's own country, and thus are able to provide little indication of a company's *real* performance over the years or even at present. Management scholars are devoted primarily to their own theories and little to discovery from empirical appraisal of the firm as a whole.

Often, even when numbers are used to evaluate nations or firms, results explain phenomena of peripheral interest (see criticisms here by Armstrong and Green, 2007, and Barrett, 2007) or, due to use of *unreal* data without consistent currency units (see Franke et al., 2007, here), explain variation in key performance indices such as ROI only to a minor degree, and unreliably so that published replications are rare (Hubbard et al., 1998; Tsang and Kwan, 1999).

Strategic experts such as Wheelen and Hunger (1989); Summer et al. (1990); and Grant (2007) recognize need for long-term time-series evaluation of firm performance. Although real-value *business unit* analyses had been completed by Buzzell and Gale (1987), analyses of real performance for firms also are complex and seem not to have been published for corporations prior to the work by Franke and Edlund (1992), based on techniques pioneered by econometricians and economic historians such as Lawrence Klein (1962; 2006) and Robert Fogel (1964; 1974 with Stanley Engerman).

Serious evaluation of corporate performance is possible using firm data easily available for over a half century—for US firms from Wharton Research Data Services, Standard and Poor's, Moody's/Mergent's, and *Fortune*; for German firms from *Fortune* and Hoppenstedt; and for both from annual reports; also for data since 1967 from the Security and Exchange Commission's 10-K Reports. Information on acquisitions, lawsuits, disasters, etc., is available from the *Business Periodical Index* and journal searches using the Thompson/Gale *Business and Company Resource Center* or the Thompson/Institute for Scientific Information's *Social Sciences Citation Index* and *Science Citation Index*. There have been time-series studies of dozens of corporations in the U.S. and Germany and for the U.S. financial industry over three to five-plus decades using the quantitative case analysis procedure demonstrated by Franke, Mento, Prumo, and Edlund (2007) in this issue of the *International Journal of Business*.

## II. GENERAL RESULTS

Time-series analyses have been carried out for American and German firms including Baltimore Gas and Electric, Black and Decker, Robert Bosch, Deutsche Bank, General Electric, Hoechst, Volkswagen, Westinghouse, and the 20 American firms analyzed cross-sectionally in this issue of the *International Journal of Business* by Armstrong

and Green (2007). Selections from 10 sets of independent variables explain most variance over time in profitability (real after-tax return on equity), real sales growth, and real market value. The relatively small number of variables is explained by Herbert Simon (1983), who stated that the world is "empty," viz., that there are few discrete explanatory variables related to corporate performance and also independent of each other. The following sets of variables often are useful in explaining performance:

**A.** *Capital intensity* is, for most firms, the first general factor explaining differences in corporate performance. It usually enters regressions of RealROE over time, always negatively if significant. That is, as noted for business units by Buzzell and Gale (1987: 135); for a corporation by Franke and Edlund (1992); for the financial industry by Franke (1987); and for nations by the World Bank (1996), Franke (1999), and Franke and Miller (2007, here), greater capital investment and resultant capital intensity--usually with less capital utilization--can "upset the applecart" of a business unit and bankrupt a company, an industry, or a nation.

**B.** *Inflation* also has negative effects on performance. Firms in competition (that is, most firms) cannot raise prices without suffering reduced sales and market share, leading to some increased costs that are not recovered. Social and political as well as economic effects of inflation are described by Fischer (1996). For more on increasing prices, see Reinhart (2007) at the end of this special issue.

**C.** *Economic growth* influences demand for products and services, generally positively, resulting in higher RealROE and Real Sales Growth.

**D.** *Monetary growth* ( $\Delta M2$  or  $\Delta M3$ ) usually is a leading indicator of economic growth and inflation—early stimulation followed by higher inflation about two years later.

**E.** *Political party* contributes to economic growth (variable C) and thus to profitability in an unexpected fashion: The more "liberal" party (Democratic in the US) is the party of greater economic growth and thus higher RealROE. The mechanism of this and slightly higher inflation (variable B) is deference of the liberal party to labor unions, which want more jobs. According to Phillips Curve beliefs and occasional reality, this can lead to higher wages. With lower taxes expected from "conservatives," business leaders usually prefer the party so labeled. But greater employment of labor also is greater employment or utilization of capital, reducing capital intensity (capital/labor ratio, variable A) and leading to greater demand and economic growth (variable C). For more on political party-economy-business relationships, see Franke and New (1984), Hibbs (1987), Marcus and Mevorach (1988), Simonton (2006), and Winter (1987).

Corporate culture and leadership often appear as two variants:

**F.** *Entrepreneurial corporate culture*, based on the CEO's personality (in a normally hierarchical business organization), is especially important in companies such as Black and Decker that are without an inherently strong competitive position in the Porter sense. Under these conditions, individualistic and innovative corporate leadership high in achievement motivation and individualism and low in uncertainty avoidance can help

(see McClelland, 1961, and Hofstede, 2001, for specifics on the three terms). Since about 1990, this entrepreneurial set of cultural characteristic also appears to have been beneficial at the level of nations, in contrast with findings for earlier periods (Franke and Barrett, 2004; Franke, Hofstede, and Bond, 2002).

**G.** *Managerial corporate culture* of high power motivation, low affiliation motivation, high power distance, and high long-term orientation is another set of variables that expresses the personality and leadership of the CEO as well as national culture (see Hofstede, 2001; McClelland, 1961, 1985; McClelland and Boyatsis, 1982; Skolnick, 1966). For companies such as Westinghouse with a number of relatively protected high-technology niches, only this corporate culture orientation is important in determining performance over time. However, for its more successful competitor, General Electric, benefits from this managerial culture characteristic were supplemented with positive effects from variable F, entrepreneurship (see Franke et al., 2007, in this issue of the *International Journal of Business*).

Measurement of corporate culture and leadership propensity by Thematic Apperception Test-based content analysis has been performed for inaugural speeches of US Presidents by Donley and Winter (1970), Franke and New (1984), and Winter (1987), and for letters to shareholders by firm CEOs (used here by Franke et al., 2007). For these and other leadership constructs affecting performance, see Bass (2007a; b).

**H.** *Regulatory and other bureaucratic shifts* can have major effects on economic performance, as described for China by Maddison (2006). In the United States, an example was the *accounting shock* that resulted from Financial Accounting Standards Board Statement No. 106 on “Employers’ Accounting for Postretirement Benefits Other Than Pensions (Issued 12/90),” with negative impact on corporate net income for the year when accumulated obligations up to then were realized—generally in 1992, or alternatively in 1991 or 1993. For year-by-year time-series analysis, quantitative case analysis adds a “dummy variable” of 1 or 0, with 1 in the year of FASB 106 realization to allow for the influence on performance of that shock to accounting protocol.

**I.** *Oil shocks* provide another set of categoric variables, with inputs of a series of zeros except for ones in 1974 and 1975, 1979 and 1980--the main years for economic impacts from shortages and price increases in energy (see Baily, 1981, and Fischer, 1996, for effects of fuel inflation on business and on society). Alternatively, changes in the motor fuel price series of the *Economic Report of the President* can be used as a continuous variable. In addition to oil shocks 1 and 2, above, effects of oil shock 3 (Gulf War, 1991) and oil shock 4 (Iraq War, 2003-present) might be considered.

**J.** *Stray events and catastrophes, major acquisitions, mergers, restructurings, and other categoric events* also are treated as dummy variables. For example, in the evaluations of General Electric (Franke et al., 2007, here), the most important independent variable affecting RealROE over time was the *demise of its primary competitor*, Westinghouse, a continuing + factor. Other significant categoric variables were a *major strike* (-), a *price fixing suit* (-), *plant closings and discontinued operations* (-) (see Cascio, 1993, on downsizing), and *oil shocks* (-) (see variable I). In

this quantitative case analysis, there were thirteen explanatory variables, split between categorical or “dummy” variables and strategic factors expressed as continuous variables. For other variables, including potentially catastrophic concerns facing corporate leadership, see John Grant’s (2007) article just following.

### III. CONCLUSION

Strategic, economic, leadership, personnel, and decision making concepts and findings can be used to help improve business performance. Using time-series regression of real corporate performance upon a range of relevant independent variables derived from the various disciplines of business, it is possible to explain most of the variance in a firm’s real return on equity or real market value over thirty to fifty years. The ten sets of independent variables yield significant or at least predictably-signed results in a number of corporate replications. In each quantitative case analysis model, certain factors are disclosed that can be *changed* to improve performance, others that can be used to *forecast and respond* to what will happen in the next few years (as in deciding whether and when to build or start up a new factory or to build up inventory). If Alan Greenspan and Ben Bernanke at the Federal Reserve can contribute to success of the U.S. economy, perhaps we in management and strategy, using similar methods of analysis, prediction, and adjustment, can contribute to corporate performance.

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