The Knowledge Based View of the Firm: An Assessment

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The knowledge-based view of the firm has gained currency in organizational theory since the 1990s. This paper evaluates it in a historical perspective, and suggests that the new theories of the firm as a receptacle of knowledge emerged in the context of the intensified knowledge communication within organizations in the early 1990s, and organizational practices that appropriated public property through the regime of intellectual property rights. This paper contends that organizational theory and practice are both in a state of dynamic mutual interaction, with theory often playing a lagging role. In other words, organizational actions precede, and are retroactively described (and legitimized) by theoretical developments. This paper subjects knowledge-based theories of the firm to scrutiny, and concludes that they resort to simplistic definitions of knowledge. Using information from other social sciences, this paper identifies some of the facets of knowledge that need to be considered in order to make the theories posited more meaningful.

Keywords: organizational theory, firm theory, management, multi-national companies, multi-national enterprises

INTRODUCTION

For scholars and professionals in the field of business management, the challenges of the twenty first century appear to be especially daunting. On one hand, the recent past has seen a tremendous acceleration in the rate of trade between countries, the growth of MNCs, and fundamental changes in work practices leading to increased productive efficiencies in organizations (UNCTAD, 2017). On the other hand, the future poses intensified challenges. Will organizations of the future be "wiser" than they were before (Bachmann, Habisch & Dierksmeier, 2017)? Will newer forms of technology be deployed by organizations to increase their grasp of the market (Block, 2014)? How can organizations better interlink their product delivery systems to offer more integrated services to their customers (Clark, Huckman & Staats, 2013)? How will they respond to the challenges of a diverse workforce by instituting systems that are equitable and just (Furnham & MacRae, 2017)?

In this paper, we advance the contention that organizational theory and practice are both in a state of dynamic mutual interaction, with theory often playing a lagging role. Our fundamental thesis follows from this development within the theory of the firm. We argue that it is not coincidental that the older theories of the firm came under attack at this particular juncture. In many ways, these debates were related to fundamental changes in work practices in organizations, often facilitated by technological changes. In other words, organizational actions precede, and are retroactively described (and legitimized) by theoretical developments.

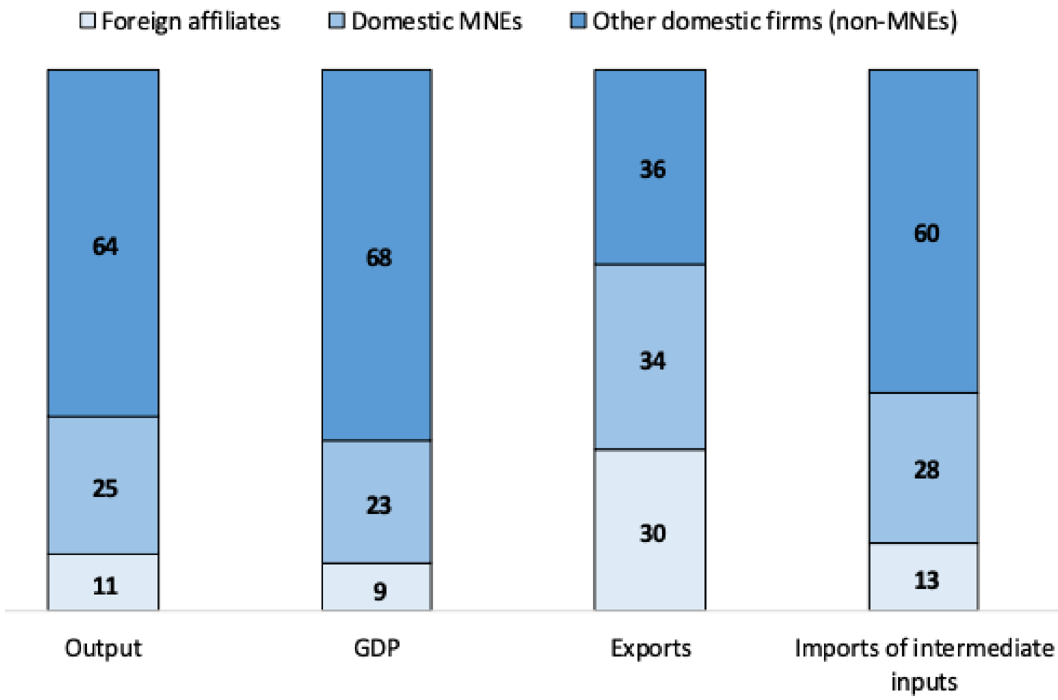
The rest of this paper is organized into three sections. In the first section, we discuss the issue of knowledge communication within firms across geographical distances, especially as they relate to the transfer of knowledge within MNCs. We also examine the new technological and organizational arrangements that need to be deployed to facilitate better coordination of diversified firms. In the second section, we unpack the concept of knowledge and what we can learn from that concept. In the process, we critique existing operationalizations of knowledge in management theory. In the final section, we engage in a discussion on the potential meaning of knowledge-based theories. We end by offering a set of caveats that both theorists and practitioners need to heed if knowledge-based theories of the firm are to become more inclusive and egalitarian.

KNOWLEDGE COMMUNICATION IN THE NEW AGE

Over the past few years, management theorists have been preoccupied with the role of the firm as an efficient carrier and distributor of knowledge (see Klarl, 2014, for a review). In particular, these theories have been applied to MNCs (Sofka, Shehu & de Faria, 2014), and suggest that the inefficiencies of trade across geo-political boundaries can be transcended by a large, spread-out organization, which can then be a conduit for knowledge flows. Knowledge transfer has not only been subjected to theoretical examination, but has also been empirically measured (see Wijk, Jansen, & Lyles 2008, for a thorough review). This theoretical interest in knowledge communication parallels extraordinary development in the movements of capital across national boundaries all over the world.

In the last quarter century, especially following the collapse of the command economies of Eastern Europe, many countries across the world have affected significant policy shifts toward "neoliberalism" at the expense of import-substitution policies. These neo-liberalist policies were developed as a means to attract foreign capital, primarily through an increased proliferation of investments by multinational corporations (MNCs) as well as multinational enterprises (MNEs) (Kant, 1996). The trend of globally dispersed investment by corporations continues till today. For example, the inflows of foreign direct investment, a key marker of MNC investment approached $2 trillion in 2013, with over $500b reported as mergers and acquisitions (UNCTAD, 2013), leading to a more concentrated global economy. MNEs and their foreign affiliates account for one third of world output and GDP and two-thirds of international trade (Figure 1). MNE's contribution to world GDP was estimated at 32% in 2016, of which roughly one third was by foreign affiliates abroad and two thirds by MNC headquarters and domestic affiliates in the home country (De Backer, Miroudot, & Rigo.2019). The top 500 MNCs of the world showed revenue growths in excess of 10% and profit growths in excess of 15% in 2012 despite the global economic downturn (Fortune, 2013), and their revenues routinely exceeded the GDP of most nations; if firms and nations were listed together (annual revenues alongside national GDP), each of the top five corporations in the world (Royal Dutch Shell, Walmart, Exxon Mobil, Sinopec and China National Petroleum) would be ranked as a top 30 nation[1]. Not only have FDIs grown, existing MNCs in these regions have begun to increase the communication between headquarters and subsidiaries. This has exposed the local industrial landscape to a bewildering influx of production methods, new technologies, and new management practices, all of which constitute newer ways of thinking and doing. It is an effort to comprehend these phenomena, and bring them into the ambit of "theory," that has led to the renewed interest in knowledge transfer in management theory.

FIGURE 1
PREVALENCE OF MNEs IN THE GLOBAL ECONOMY, 2016 (%)



Source: OECD Analytical AMNE database

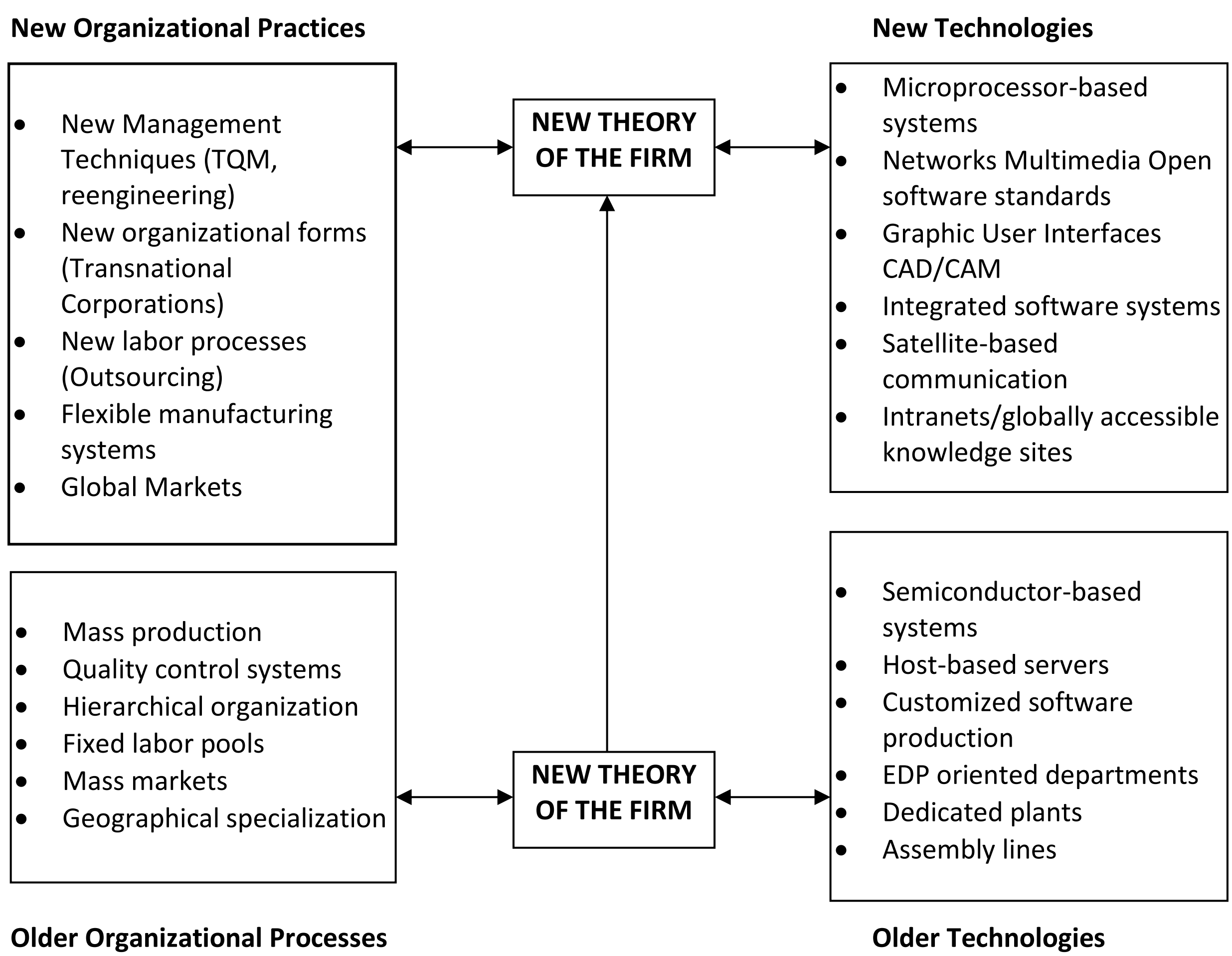
One side effect of theorizing about knowledge flows has been that researchers have been forced to re-evaluate their fundamental theories of the firm. Most knowledge theorists, despite the apparent heterogeneity of their subject matter, share dissatisfaction with "static" theories of the firm, in particular the transaction cost perspective. New theories of the firm as a receptacle of knowledge emerged in the context of the intensified knowledge communication within organizations in the early 1990s. In that time, as we crested the socially constructed temporal milestone into the new millennium, we saw a sudden intensification in management theory of "knowledge-based" perspectives in organizational theory, especially in strategic management.

It may be recalled that most management theorists have hitherto relied on the transaction cost perspective to understand the existence of the firm. Under the premises of this theory, economic activities are internalized into hierarchies (firms) when contractual and market-based arrangements fail, primarily as a consequence of bounded rationality on the part of actors, asset specificities in transactions, and the possibility of opportunistic or "morally hazardous" behavior by contractual partners (Williamson, 1985).

In the 1990s, a new breed of researchers sought to bring a new understanding of MNCs to bear in postulating an entirely new theory of the firm. Advocates of the knowledge-based theory of the firm (Kogut and Zander, 1996) attempted to use the phenomenon of knowledge communication to explain the very existence of firms. Through this theory, they attempted to move explicitly from earlier, contractual theories of organizing into more processual, knowledge-based perspectives. They argued that instead of a series of contractual arrangements, firms could be reconceptualized as efficient storehouses of knowledge, knowledge that cannot be stored within individuals, but that emerged in a tacit way when organizational members communicated with each other. They specifically rejected the opportunism hypothesis of transaction cost economics (Conner and Prahalad, 1996), viewing organizations more as entities of cooperation, collaboration and communication. While the advocates of the transaction cost approach to organization theory valiantly sought to defend their theoretical position from the onslaught of the knowledge-based researchers (Foss, 1996), it is safe to say that knowledge intensive theories have carried the day, especially in an era where the talk of dynamic capabilities has become hegemonic in organizational research (Helfat & Winter, 2011).

Organizations became larger and more geographically dispersed, primarily because newer techniques of organizing and information management made it possible for them to expand. These techniques included newer technologies such as computers and flexible machinery, newer models and techniques of management such as TQM and reengineering, newer organizational forms such as the transnational corporation, newer labor processes such as outsourcing, newer forms of markets such as specialized niches, and the overall globalization of production, consumption and capital accumulation. For instance, let us focus on two aspects of this transformation, namely the changes in information technology and the re-organization of workflows across international boundaries. Figure 2 details some of the new technologies and new organizational processes that began to be routinely deployed by organizations in the recent past. And many of these newer modes of organizing will have profound impacts on the way we will characterize the firm. Outsourcing, for instance, rendered the boundaries of the firm fuzzy. The use of software products such as intranets made it possible for organizations to achieve worldwide coordination in various organizational activities, by sharing product launch-plans, information about production and benchmarking. Thus, as Figure 2 suggests, newer technologies and practices in the firm demanded newer theories to understand it.

FIGURE 2
CHANGES IN ORGANIZATIONAL THEORY/PRACTICE IN THE 1990s



The control of the subsidiaries of these geographically dispersed firms was predicated upon the extensive use of information technology. A number of key changes in this area were useful in facilitating newer communication systems within firms. At the purely technical level, we saw the move from traditional semiconductor-based systems to microprocessor-based systems, from host-based to network-based systems, the creation of open software standards, use of multimedia technology, computerized participation systems within organizations modeled after vendor-customer partnerships, object-oriented programs which allowed for a factory mode (as opposed to craft-mode) of software production, graphic user interfaces, and integrated software applications (Tapscott and Caston 1993). Thus, technology was instrumental in pushing the boundaries of the corporation across product markets, geographies and cultures. These technologies especially worked to the advantage of the MNC in the past few decades. This has had tremendous implications for organizational scale and scope. Organizations became much bigger, simply because they had the tools to monitor a larger span of control, both at the level of geography and at the level of product market diversification. For instance, while in the 1990s, the largest corporations in the world tended to be manufacturers like GM, with annual revenues of less than $200b; we now see corporations like Walmart, which do not manufacture a thing, flirting with $500b in annual sales in 2014, while service corporations like Google show a year-on-year growth of 20% and more, a trend that shows no signs of slowing.

Apart from the impact of new technologies and new organizational processes on day-to-day operations, we should also be mindful of another important role that knowledge communication played in the geographically diversified firm. According to more interpretive theorists of the firm, organizations may be also seen as cultural phenomena, which change, develop and legitimize themselves primarily through interactions between various sub-groups (Garsten, 1994). These interactions and communicative processes are essential to create a context of shared meaning within organizational members, and an organizational culture.

Such a creation and sustenance of a shared organizational identity and culture had often posed a number of problems in the past, especially for MNCs. MNCs necessarily have to rely on innovative ways of long distance communication as a way of developing and sustaining a coherent and shared meaning system. One such challenge in cross-border transfer organizational knowledge is cultural difference between transferring and recipient organization (Bhagat 2002). Bhagat (2002) proposed a conceptual model of cross-border transfer of organizational knowledge that explicitly takes into account the nature of cultural variance.

To that end, large corporations have taken the lead in deploying technology for organizational communication, often expending a lot of resources to create sophisticated communication systems within the firm. These communication systems are used to fulfill a variety of key organizational objectives. Not only do they facilitate the development of formal integrative mechanisms, whereby all organizational activity can be coordinated, but they also create vertical socialization mechanisms, where hierarchical transmission channels are created and sustained. They may also be used to facilitate decentralization, by eliminating or reducing the need for headquarters to resort to direct control of subsidiaries (Chanson & Quélin, 2013; Gupta and Govindarajan, 1996). Indeed, the MNC has been theorized by many scholars as a superior mode of organization precisely because of its ability to effect efficient knowledge flows across political boundaries. It achieves this by utilizing networks of information involving multi-location data-inputs, centralized as well as dispersed information processing, and constantly evolving modes of data analysis and knowledge-processing capabilities (Kogut and Zander, 1993).

It is through the successful management of organizational identities and cultures that MNCs have managed to achieve an exponential growth and geographic spread in the recent past. The swift increase in scope and power of MNCs as economic units in the last quarter of the 20th century can scarcely be overstated. By the early 1990s, the top 300 MNCs accounted for over 25% of the world's productive assets (Barnet and Cavanagh, 1994). MNCs became particularly adept at deploying knowledge in a variety of ways, including new product development routines (Subramaniam, Rosenthal and Hatten, 1996), overlapping project activities (Takeuchi and Nonaka, 1986), cross-functional teams (Griffin and Hauser, 1992) and innovative structural linkages (Dinur and Inkpen 1996). Examples of these included new product launches, new production process incorporations, adoption of newer methods of quality assurance, changing of routines related to vendor management, the incorporation of new information systems and technologies into the organization, or newly instituted management practices specifically introduced at the behest of the headquarters into the subsidiary.

While it was obvious to the organizational theorist of the 1990s that product development, inter-unit communications and project management involved the exchange and communication of knowledge, what exactly was this knowledge? How could one we measure it? How, for that matter, could we define it? Theorists certainly needed a working definition of knowledge they were to subject it to any critical scrutiny. In the next section, we will describe their attempt to develop that definition of knowledge through an analysis of this concept.

THE CONCEPTS OF COMMUNICATION OF KNOWLEDGE

Thus far, we have established that the communication of knowledge has been central to the rapidly expanding firm of the recent past, and would be equally important for the firm of the new age. However, in order to understand the specific challenges that face the firm of the new age, especially with respect to knowledge, it becomes essential to subject this term to some scrutiny. After all, the term "knowledge" has varied meanings depending upon the various perspectives and positions from which it is studied. In our case, we wish to explore only those aspects of it that are related to its communicability.

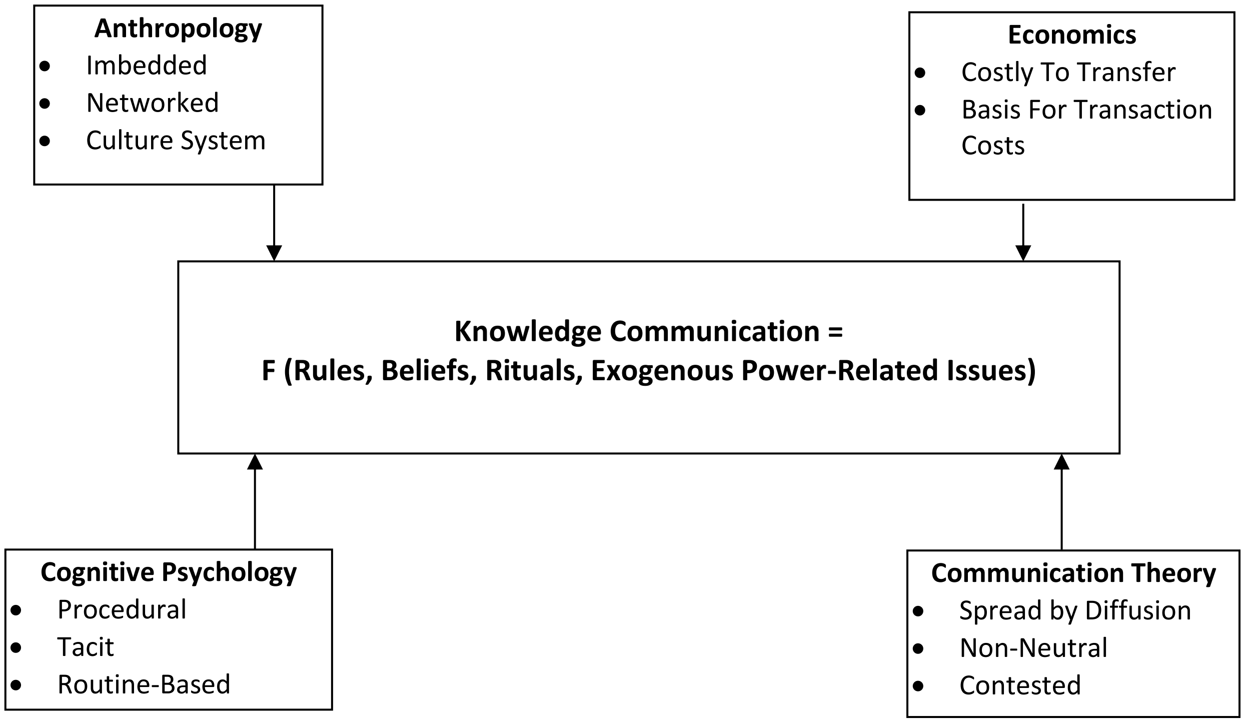
Economists have studied knowledge communication with great interest. An economic perspective on knowledge communication would entail examining the costs associated with such a knowledge transfer. For example, one study of the cost of technology transfer across MNC boundaries estimated it to be around 20% of the total project cost (Teece, 1977). This was a truly astonishing figure that challenges the claims of MNCs that they are efficient vehicles of knowledge communication. Moreover, the 20-percent figure was the average across a number of industries. Individual values were as high as 59% of total project cost. A mitigating factor may be the complementarity between knowledge transfers and R&D activity in the host country. Belderbos, Ito, and Wakasugi (2008) found that both of those sources of technology increased the marginal productivity of the other. Other economic theories have focused on routines of knowledge communication among non-competitive and collaborative organizations. For example, taking a look at the current global COVID-19 pandemic, there has been a great need for transnational actions to help control the spread and communicate up-to-date information regarding the novel virus. Many countries are currently engaged in participative efforts and one can look to one of the most tremendous transnational efforts in recorded history which was the eradication of smallpox.

Anthropologists studying organizations (Darrah, 1996) studied the tacit aspects of organizational knowledge systems (drawing from Polanyi (1966)). Some anthropologists (Acheson, 1994) have attempted to uncover the imbedded nature of organizational routines. They argued that after all, a firm exists in a network of other supporting institutions in mutually reinforcing cycles of influence. Knowledge then, was a system of inter-linked ideas, a set of social discourses that could be debated over vast geographical distances, or a shared system of collegiality. By extension, knowledge communication is a process by which organizational identity itself is shaped (Geertz, 1988).

Communication theorists suggested that knowledge communication is achieved through diffusion, translation, imitation, or isomorphism (Czarniawska and Joerges, 1996). They also pointed out that knowledge is not a "neutral" commodity, but is extremely value-laden, contextual and contested (Putnam and Chapman, 1996). Knowledge transfer then, was more an act of transformation than one of information and involved the exercise of coercive, referent and normative power (Deetz, 1995).

This heterogeneity of perspectives regarding knowledge communication across a spectrum of social sciences indicated that knowledge-based theories of the firm had a long way to go. Knowledge is a complicated construct, and as Figure 3 makes clear, it has to be understood as a function of rules, beliefs, and rituals. Its relationship to power can never be over-emphasized. However, knowledge-based management theories rarely considered this complexity, choosing instead to simplify the term in order to make it convenient and measurable. Despite their apparent commitment to understanding organizational routines and the procedural aspects of knowledge, many of them rarely examined the complexity of knowledge flow, resorting instead to simplistic operationalizations of knowledge in empirical studies.

FIGURE 3
KNOWLEDGE AS CONCEPTUALIZED IN OTHER SOCIAL SCIENCES



More significantly, many of the new theories of knowledge communication represented not so much a theoretical innovation as an attempt to make retrospective sense of what had already happened in organizations. Such reverse theorizing often has the side effect of legitimizing all organizational activities through the discursive power of theory. Indeed, most knowledge-based studies of organizations were and continue to be inordinately celebratory, ordaining organizational spread as a technological inevitability. That, however, only tells half the story. Corporations have taken advantage of new technology to geometrically increase their geographic spread. At the same time, many corporations have built their fortunes on extremely questionable, often downright illegal and immoral practices. These practices not only include blatant acts such as bribery, deceit and violent behavior but also many times, involve perfectly legal behavior in indigent countries that may have been illegal in their host nations. For example, Sikka and Willmott (2010) argue that the practice of transfer pricing is a major source of tax avoidance, which aids capital flight. This information of course was available to all who cared to look in the 1990s as well (e.g. Mokhiber and Weisman, 1997). A critical analysis of global management from that time often reveals an insufficient attention to some of the more egregious inequities of corporate globalization (Mir, Mir & Hussain, 2006). Even mainstream economists were beginning to wonder if the global marketplace driven by corporate greed had proven to be little more than a “Judas economy” (Wolman and Colamosa, 1997: 1). Some members of the popular press went so far as to denounce global capitalism as a “dangerous hybrid”, contending that while “capitalism is supposed to excel at allocating funds efficiently…it didn’t” (Newsweek, 1998: 42). With that in mind, we would like to look at a ore holistic approach to knowledge communication and how that may lead to better organizational theory.

TOWARD A HOLISTIC ATTITUDE TO KNOWLEDGE COMMUNICATION

Thus far, we have tried to historicize the emergence of the knowledge-based perspective in organizational studies and its emergence may have coincided with a huge expansion of corporate power and impunity. To that extent, we imply that we need to be suspicious of these theories (and their inheritors, such as the dynamic capabilities perspective) as handmaidens to corporate elites, and agents of global capital. In this context, we have tried to point toward the extremely complex and contextual nature of the term "knowledge," and knowledge-based theories of the firm. We believe that certain specific historical, technological and organizational transformations have been behind these knowledge-based theories, and that these approaches have reflected newer challenges and opportunities that organizations face, particularly as they move into the new age. Moreover, knowledge is an extremely complex term, lending itself to a variety of contingent definitions. Unless a more complex and enduring analysis of knowledge is developed, management theorists will forever be flipping between the reductive generalizations of the transaction-cost perspective and the popular but deficient knowledge-based theories that dominate the landscape of management theory.

We therefore suggest that different research agendas need to be developed while studying corporations, especially by researchers who are interested in exploring the impact of these new developments on strategy. For example, from the perspective of MNCs that are intensifying knowledge transactions across national boundaries, the following questions could be useful:

- What are the specific power relationships that guide the practices of knowledge flow from the headquarters to the subsidiary of a MNC? How is this power transmitted?
- How are the secondary institutions (governments, international regime groups, domestic and foreign competitions, unions, trade and industry organizations) employed to anchor the knowledge communication process? How are they managed?
- What forms of coping mechanisms are employed at the local level to deal with knowledge transfer that may appear to be threatening to local labor? How will labor at the headquarters respond to knowledge transfer to the subsidiaries, especially knowledge that may lead to the displacement of work to those regions?

Ultimately, knowledge transfer is a much-contested terrain. On one hand, older ways of thinking and doing are supplanted, sometimes unilaterally, by organizations that seek to standardize their operations across the globe and take advantage of economies of scale. On the other hand, in an era that seems characterized by downsizing and reengineering, labor at the headquarters is often apprehensive about letting critical knowledge slip away into areas that may be sources of future competition for jobs. Often, labor in the developed world has to watch passively as most of their productive operations are sent overseas. On the other hand, labor in the "periphery" is subjected to work-intensification, and rarely enjoys its wealth appropriation. In the process, MNCs become more productive and profitable, but their gains are not evenly shared, leading to increased polarities in income.

Is there a way out of this cycle? It seems to be increasingly evident that the solution to this predicament is for theorists like us to help global labor to use existing democratic institutions and the institutions of civil society to make organizations more responsible. This will mean greater resort to rules, laws and public opinion to ensure that organizations become more socially responsive and ethical with respect to these stakeholders. Only through a renewal of the social contact will we be able to achieve some degree of a symbiotic relationship between labor and management in the new age.

Indeed, to a great extent in this paper, we aspire to join that effort. We suggest that a redefinition of the responsibilities of management with respect to labor is not only crucial to labor; it is crucial to management as well. For unless labor and other stakeholders are accommodated into the beneficiaries of corporate growth in the new age, we risk creating a crisis of under-consumption. After all, for the cycle of corporate growth to continue, it is essential that production and consumption balance one another. Unless the labor force is well compensated, it will cut back on consumption, leading to an industrial crisis where goods are efficiently produced, but stay on store-shelves leading to a recession (a minor version of this crisis was alarmingly visible in the 2008 economic crisis). If we are to avoid a similar crisis in the future, a renewal of the social contract is an urgent necessity.

DISCUSSION

This paper has subjected knowledge-based theories of the firm to scrutiny, and concluded that they were resorting to simplistic definitions of knowledge. Using information from other social sciences, we identified some of the facets of knowledge that needed to be considered in order to make our definitions more meaningful.

In conclusion, we would like to suggest ways in which knowledge-based theories of the firm can become more responsive in the new age. A good theory must have the capacity to inform practice, rather than simply follow it. At the same time, it also needs to be close to empirical reality. Knowledge-based theories of the firm have the capability of being excellent theories on both counts. Firstly, their roots lie in the empirical reality of multinational expansion, and the fact that despite operating in a tremendous heterogeneity of cultural, political and technical environments, these corporations are able to maintain a distinct identity. Also, the reality of the tremendous magnitude of technology transfer and knowledge communication in these corporations makes the subject matter of the knowledge-based view of the firm particularly apt. Through socialization mechanisms, through integrative routines, through the use of information technology and through the mediation of management consultants, organizations have continued to rapidly expand their knowledge communication routines.

However, in order to get better at informing the organizational practice, we believe that knowledge-based theorists need to accomplish two tasks. First, they need to unpack the concept of knowledge and view it as a complex phenomenon that is communicated not merely at the cognitive level, but at the level of routines, myths and ceremonies. Also, they need to take all stakeholders of the firm into account when they discuss the communication of knowledge between firms. They should avoid becoming the exclusive stewards of shareholders and top management and include labor as an important constituency.

The interests of labor should be an important element of every theory about the firm because knowledge is held by an individual, not by an organization. The ability of a firm to integrate knowledge held by individuals within the organization creates its competitive advantage. When employees are mobile, the organizational capability depends more on the integration mechanism than on the specialist knowledge that employees possess. This makes increasing common knowledge more important than deepening specialist knowledge leading to organizational practices such as cross training, job rotation, etc. The broader the scope of knowledge being integrated, the harder it is to replicate (Grant, 1996). In building organizational knowledge, individual interactions with one another must take account of what each other is doing or is about to do. In the face of the action of others, one may aboard or revise their own thoughts. The action of others has to be taken into account to fit one's own line of thoughts in some manner to the thoughts of others (Weick et al, 1995). Social interactions affect the constructions of knowledge or logic because our intention and feeling do not grow within us but between us. An individual creates novel thoughts in the context of interaction with others and then communicates to the larger community. The larger community then generalizes these ideas and then it becomes part of culture and knowledge of the firm (Weick el. al 1995). By taking into account these ideas of knowledge and how it is integrated, we can create more inclusive knowledge-based theories of the firm.

ENDNOTE

1. Data developed by comparing corporate statistics from http://money.cnn.com/magazines/fortune/global500/2013/full_list/ and national data from http://data.worldbank.org/indicator/NY.GDP.MKTP.CD.

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