

ROTTERDAM SCHOOL OF MANAGEMENT, ERASMUS UNIVERSITY

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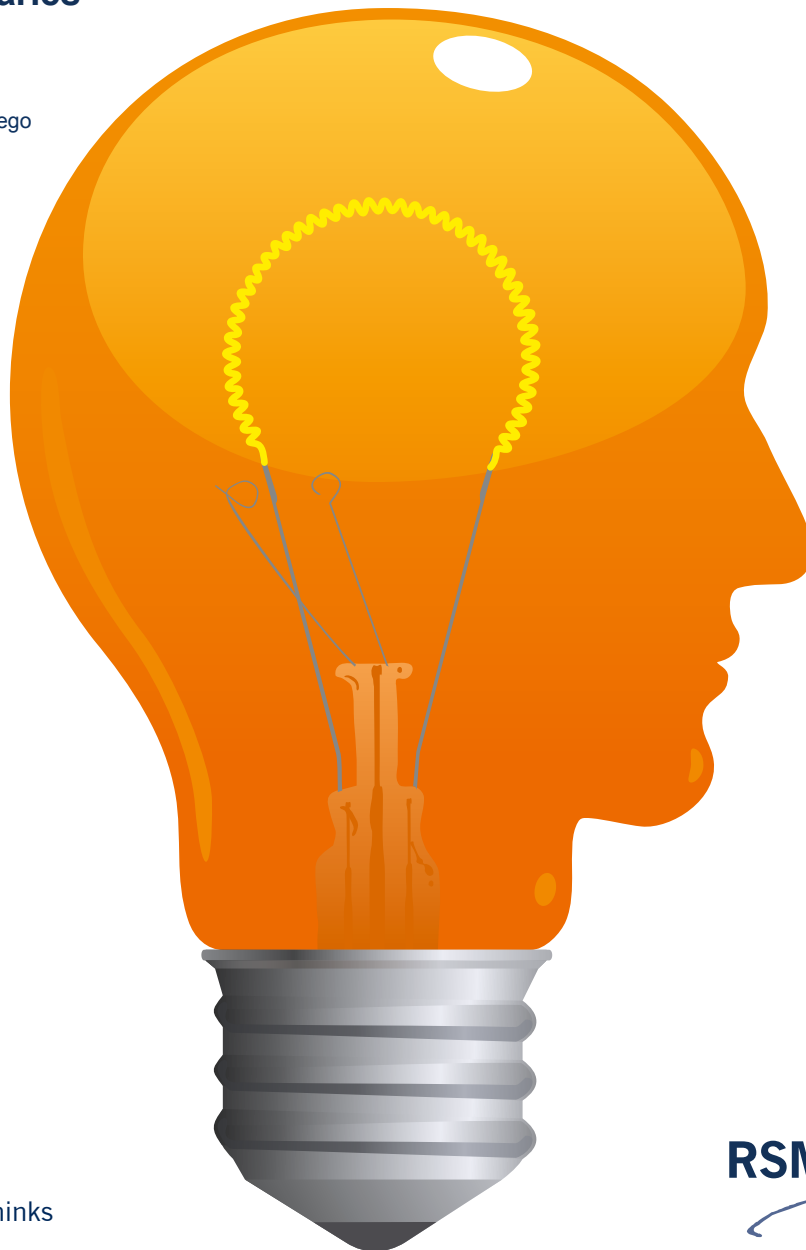
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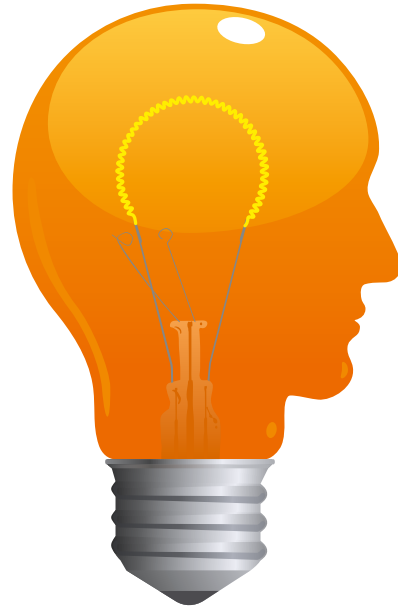
Real intellectual innovation happens when multi-disciplinary researchers get together and collaborate. And innovation is urgently needed, if we are to take corporate sustainability to the next level. Supporting this shift, nine 'Planetary Boundaries' have been identified by natural scientists, defining the parameters of a safe environment for humanity.

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by Berend Wierenga

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Coping with complexity in emerging markets

by Suzana B. Rodrigues

With low growth driving European and American businesses to faster-growing economies, how do these foreign companies handle the complex challenges they face in emerging markets?

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The perils of pursuing profit

by Michel Lander

A heightened focus on profit at traditional professional service firms will almost inevitably lead to deterioration in individual and collective professional behaviour at the larger of those firms. There are valuable lessons to be learned here that could be applied in other industry sectors.

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Co-operatives and channel governance

by George Hendrikse

The inference behind the economic principle known as Gresham's Law is that 'bad money drives out good money'. The Greenery, a €1bn-plus annual turnover fruit and vegetable processing co-operative in the Netherlands, found this to be almost literally true.

Introduction



Two fundamental goals are central to the existence of business schools: the education and development of managerial talent with the skill, ability and vision to lead both business practitioners and researchers in their pursuit of management knowledge that innovates, transforms and inspires.

The traditional business school model, based on the education of students and the development of new research, does not automatically lead to the creation of maximal value for the business community. Because of this it is essential that business schools rethink their strategies, re-evaluate their models, and make managers, professionals, and all other stakeholders integral to their primary operations. This is a process known as valourisation.

RSM Insight is an instrument through which we seek to offer value to our stakeholders. The management articles in this issue provide thoughts, opinions and research-based answers of relevance to the business challenges of today, such as: how to cope with complexity in emerging markets; why the pursuit of profit can be harmful to professional service firms; what corporate sustainability strategists can learn from natural scientists, and how to improve decision-making in marketing management.

Individually each article offers value. Collectively they provide a perfect illustration of what valourisation means in a business school.

Best wishes,

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The insurer of the future

by Tim Skelton

RSM has entered into a long-term partnership with Nationale-Nederlanden to establish a research-led investigation into how the insurance sector of tomorrow may take shape.



There are frontrunners in every field of business, and those who want to stay ahead of the pack face constant pressure to innovate. The world of insurance is particularly fluid: rapidly changing consumer demands, ever-tightening rules and regulations, fierce competition from rivals, and new business models, all mean insurance companies must remain dynamic or

risk being left behind. Moreover, the physical way in which they interact with and serve their customers is also evolving, with a greater emphasis being placed on technological innovations such as mobile internet, apps, and a broadening range of social media platforms.

All businesses need to adapt to these new ideas, and identifying the

best way forward presents an excellent opportunity for academic research and innovation. The Centre for the Insurer of the Future was therefore set up to exploit a vast pool of knowledge, talent and experience, in order to identify what will work, and what might not, for the insurer of tomorrow.

The original idea for the centre came from Tom Klijhuis, CEO of one of the Netherlands' largest insurance companies, Nationale-Nederlanden, and was developed with RSM's Professor Peter Vervest. Launched in March 2012, it is a collaboration between the insurer and RSM. Combining the best ideas and resources from the business world and academia, the partners will conduct joint research into the essential requirements for a future insurance company.

Professor Eric van Heck of RSM is the Centre for the Insurer of the Future's scientific director. 'The motivation came initially from Nationale-Nederlanden,' he admits. 'They wanted to have a link to scientific research, and they liked what they saw we were doing in the field of next-generation business.'

Indeed, with more than five million private and business customers, Nationale-Nederlanden is already a major player in the Dutch insurance market, and has been active in the sector for 170 years. But to remain at ▶

The insurer of the future (continued)

by Tim Skelton

the top, its overriding concern must be to offer the best service to clients. Thus it was that RSM's emphasis on groundbreaking research, and practices relevant to a sustainable business environment, caught its eye.

'Nationale-Nederlanden wants to innovate constantly,' CEO Tom Kliphuis says. 'That's why we entered into a partnership with RSM. To get fresh ideas from outside the company from

by 'providing expertise, getting in touch with tomorrow's customers (students), developing and testing new academically supported ideas in a "safe" laboratory environment, as well as sourcing knowledge from within the company,' says Kliphuis.

The centre's approach is founded on three fundamental pillars: student research and engagement; PhD research; and Thought Leadership

Research will be far reaching and span a number of different departments at RSM. Carried out in close collaboration with its business partner, it will cover subjects vital to the world of insurance, and focus on the cutting edge of marketing, strategy, information technology, innovation and entrepreneurship. Areas addressed will include new business models, digital platforms, social media, apps, online e-marketing in retail environments, customer dialogue on pensions, and transforming client processes through lean and agile management.

Moreover, it will look at ways to adapt organisational culture at both management and employee level, and promote 'intrapreneurship' – the nurturing of innovation within an organisation. Together these studies will help form a complete picture.

“Nationale-Nederlanden wants to innovate constantly. That’s why we entered into a partnership with RSM.” Tom Kliphuis, CEO, Nationale-Nederlanden

young academics. It will be a long-term partnership. Within a five-year period, around ten graduate students each year will carry out their Master's thesis research with us. We will also look at options for PhD candidates. This co-operation is intended to give us new insights and to help inspire students.'

For its part, the insurance company prides itself on placing a strong focus on becoming a more customer-driven organisation. In order to achieve this, it wants to develop a clear vision of what it needs to do to transform into the "insurer of the future". RSM will support it in its transition,

Sessions. 'The first pillar is a collaboration with a Master's thesis trajectory, in which students can be linked up with and connected to different teams,' Prof. van Heck explains. At the time of writing eight students were working there, and they will be able to use the work they do for their graduation assignments. 'Secondly, we will connect with longer-term research, by setting up PhD trajectories. We are currently developing several of these. The third pillar is our Thought Leadership Sessions – a series of discussions and workshops that focus on specific themes.'

Thought leadership

Operating in parallel with these student and postgraduate efforts are the Thought Leadership Sessions. Led by faculty members and senior educational staff, the first of these was held in June and focused on "crowdsourcing", a novel practice in which tasks are outsourced – via online or offline media – not to any specific entity, but instead to a widespread and even undefined group of people. The aim was to

investigate this relatively modern concept, and to brainstorm how it might be applied within the context of insurance. A second session is also now in development. This will focus on social media, and how that too can be made to work for the insurance business.

As the project progresses, representatives from RSM and a coordinator from the partner insurer will meet regularly to assess the value of the research being carried out, and to decide on any future changes in direction that might become necessary.

What exactly does the centre expect to achieve with its three-pronged approach? 'We are hoping to provide research results that will inspire Nationale-Nederlanden to become a leader in the insurance industry,' Professor van Heck says. 'The company was keen to get support for collaborating with us, and the fact that they are driving the project forward clearly shows their level of commitment to it.'

But the partnership is not a unidirectional affair; rather, it is a symbiotic and mutually beneficial exchange of ideas. While giving Nationale-Nederlanden access to some of the best business brains in academia, it also provides RSM with an excellent opportunity to link up with an innovative company at the forefront of

its field. 'There is a two-way motivation involved,' Prof. van Heck explains. 'The involvement of Nationale-Nederlanden provides RSM with new research opportunities - and of course funding - as well as providing us with new ways of collecting empirical data, and giving us access to these.' In short, it presents everyone concerned with a unique opportunity.

In addition to its current activities, plans are now afoot for the centre to broaden its scope in the years to come. 'In the future we may also develop executive sessions, to share the knowledge that we are acquiring and

will acquire as a result of the research,' Prof. van Heck says.

Either way, the ultimate aim of the Erasmus Centre for the Insurer of the Future is to mould an insurance company that will still be relevant many years down the line. Therefore, without a crystal ball to hand, only time can effectively judge whether its efforts have been a success or not. But when preparing for the challenges of tomorrow, there is no better time to start than today. ■

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“We are hoping to provide research results that will inspire Nationale-Nederlanden to become a leader in the insurance industry.” Prof. Eric van Heck, Scientific Director



Sustainable revenue management

by Ting Li, Peter Vervest and Milan Lovrić

The introduction of public transport smart cards means it is now possible to forecast how behavioural change stimulators, such as time-variable pricing, will impact passenger activity. This is an invaluable tool for managing revenue in a sustainable way, not just in the public transport sector, but also for every industry constrained by peak-loading capacity.

Public transport, utilities, telecoms and other services that form part of the social infrastructure cannot afford to focus only on profit. Long-term factors such as environmental impact and social perception are also essential considerations if political intervention is to be avoided. Successfully managing all of these sustainably means striking the right balance between profit, people and planet.

accommodate high peaks means underused resources during the quiet times, which still continue to incur running costs. The key to optimal efficiency and overall sustainability lies in evening out the load.

The public transport sector provided an ideal case for us to examine whether this could be achieved through encouraging passengers to switch journey times. The plentiful

when demand is low. The vehicle space required to satisfy peak capacity is uneconomical to run the rest of the time. But simply switching to smaller vehicles isn't necessarily a viable option.

Lowering the highest peak demand would mean the maximum vehicle size could be smaller. And that would mean less wastage at other times. This would result in more cost-effective and comfortable public transport that would also attract more customers away from their cars, further reducing CO₂ emissions and increasing revenue for PTOs.

We therefore wanted to find out to what degree we could reduce the highest peak demand through stimulating passengers to modify journey times, incentivised by different fares for different time periods. The aim was to spread peak demand over a longer time period and achieve more even use of the system, without losing customers.

“...we were able to gain deep insights into the effects different permutations have on revenue and passenger behaviour.”

Large differences between peak and non-peak activity levels are especially bad for organisations whose infrastructure is based on the maximum load that can be carried at any one time. Whether transporting passengers, power or electronic data, being sufficiently equipped to

availability of passenger journey data through smart cards made it possible to conduct feasibly realistic simulations of extremely complex situations.

Public transport operators' (PTOs) obligations to serve communities mean they must provide both sufficient peak capacity and an acceptable service

Using smart card data

To do this, we developed a Decision Support System that enabled us to simulate passenger reaction to fare structure changes. Taking input from smart card data and results of sensitivity analyses to price and journey change, this system uses the advanced scientific technique of agent-based modelling to reveal the



journey patterns which emerge when driven by passenger demand under different circumstances.

We ran simulations on four different pricing strategies that raised and lowered prices during different periods throughout the day. Through doing this we were able to gain deep insights into the effects different permutations have on revenue and passenger behaviour.

Conclusions

Time-differentiated pricing structures can effectively stimulate passengers towards desired behaviour and form a basis for sustainable revenue management that satisfies profit, people and planet.

While certain passenger need factors mean it will never be possible to eliminate periods of very high and low demand, the extremities of those demands can at least be manipulated to improve cost-efficiency and reduce environmental impact within socially acceptable boundaries. The additional

benefit of a transport system that utilises its resources better is an overall reduction in overcrowding and therefore a more comfortable passenger experience.

We concluded that it is possible to leverage the great wealth of data collected by smart cards for developing policies that lead to increased revenue, better financial and environmental efficiency and higher customer satisfaction. However, not all three can be maximised at the same time. As one of these key performance indicators improves, others will worsen. This trade-off means policy makers need to determine where their own balance lies.

Implications

Any studies that have the potential to affect societies need to consider the extreme complexities within them, including networks, emergent behaviour, and macro-level and micro-level behaviour. Because our studies set out to break new ground in examining these complexities, the Dutch National Science Foundation (NWO) funded them. This is indicative of the importance of complexity research to the future of societies.

The Decision Support System we developed for our studies can be adopted by other public transport

operators to explore the impact of various pricing permutations on their own customers. This can provide relevant information for strategic discussions between public transport operators and their governments. ■

This article is based on the paper *Sustainable revenue management: a smart card enabled agent-based modelling approach*, written by Ting Li, Peter Vervest and Milan Lovrić. The paper is to be published in *Decision Support Systems* and is available online at: <http://dx.doi.org/10.1016/j.dss.2012.05.061>

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Planetary boundaries and corporate sustainability

by Gail Whiteman & Paolo Perego

Real intellectual innovation happens when multi-disciplinary researchers get together and collaborate. And innovation is urgently needed, if we are to take corporate sustainability to the next level. Supporting this shift, nine ‘Planetary Boundaries’ have been identified by natural scientists, defining the parameters of a safe environment for humanity.



The systemic approach to sustainability of the nine Planetary Boundaries overview shows us the bigger picture: it highlights the danger zones, where we are already dangerously overstepping safe boundaries, in spite of sustainability programmes. With the help of this new input, business researchers now have a framework for the development of more effective corporate sustainability measures, and a collective approach to potentially stemming, even reversing, ecological damage.

Sustainability has become widely accepted in business as a

necessary investment item: 75 per cent of businesses now include it in their strategic planning budgets. Yet deterioration of our global environment continues, and is even accelerating. The nine Planetary Boundaries indicate the limits of ecological damage that we must not exceed, if we are to sustain a safe environment for life on earth. Something new needs to happen, to enable us to slow and reverse negative trends. Corporate sustainability measures need to integrate the insights of natural scientists into business research and measurement.

Our research, forthcoming in the *Journal of Management Studies*, introduces this topic to the business literature and considers the implications for corporate sustainability.

Redefining sustainability

Business researchers over the last few decades have tended to look at environmental issues like toxic emissions, water use or carbon emissions in isolation. Scholars

typically focused on specific industries, individual companies, or separate countries. This works, up to a point. Companies increasingly understand and subscribe to sustainability programmes. However, the Planetary Boundaries concept recognises that environmental issues cannot be managed in isolation. And business cannot afford to ignore the fact that eco-systems are made of interlinked social and environmental processes. We therefore need a more systemic approach to business research, and business sustainability programmes.

Endangered planet

According to Johan Rockström and colleagues (2009), three of the nine key Planetary Boundaries already need urgent attention: the rate of biodiversity loss, nitrogen cycles, and climate change. Crossing the thresholds of these boundaries – as we already have – increases the probability of their negative impact on human well-being. Focusing on single issues such as toxic emissions, however, doesn't take the bigger picture into consideration. Multiple environmental and social processes interact to impact conditions on a regional, even global scale. Similarly, business research that investigates single-issue topics in corporate sustainability also misses the bigger picture.

We recommend more systematic social-ecological research that assesses how corporate actions simultaneously affect multiple boundaries, like land use and biodiversity, and how these changes may reduce planetary resilience and feed back into the global climate system. We need more research on the collective role of companies in biodiversity loss, and on global nitrogen and phosphorous cycles. Sustainability is no longer a fuzzy concept, but a matter of systemic investigation.

Key to the success of this approach is, of course, the availability of relevant data. We need a nitrogen disclosure project, for example, in the same way as we have increasing disclosure of carbon emissions in corporate reporting.

Business research is disconnected from advancements in the natural sciences – and this is a both a gap and an opportunity. By integrating our research within advancements like the Planetary Boundaries framework, business researchers can add value. With its systemic approach to corporate environmental programmes, the Planetary Boundaries approach offers a practical contribution to more effective sustainability measures, and helps set the future research agenda for business research.

Greater awareness of the danger thresholds related to each planetary

boundary provides individual firms and business associations like the World Business Council for Sustainable Development (WBCSD) with a collective yardstick to measure global sustainable performance, and offers strategic guidelines for assessing the scope of corporate sustainability efforts. The urgency of the need to address the three interrelated, priority thresholds – biodiversity loss, nitrogen cycles, and climate change – encourages firms to consider their impact and actions in these areas and to anchor sustainability reporting within the Planetary Boundaries framework.

The role of business

Senior executives are not immune to the need for more systemic collective approaches to sustainability. According to Peter Bakker, former CEO of the multinational company TNT and President of the WBCSD: 'As a company we can reduce our carbon footprint dramatically. But the world's still driving off a cliff. We need a system change.'

Practical action has started to happen. The WBCSD recently signed a Memorandum of Understanding with the Stockholm Resilience Centre to consider how to disaggregate the nine boundaries into actionable targets for firms and industries. It will take a collective effort to solve the issues facing

our planet. We need transdisciplinary integration, and continued collaboration between business management scholars and ecological leaders. It's an exciting and innovative prospect, and it needs to happen. ■

This article draws its inspiration from the paper *Planetary Boundaries: Ecological Foundations for Corporate Sustainability*, which is written by Gail Whiteman, Brian Walker and Paolo Perego, and is to be published in the *Journal of Management Studies*. It is available online at: <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-6486.2012.01073.x/full>

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Understanding marketing decision-making

by Berend Wierenga

While a whole range of factors influences the outcomes of a marketing policy, it is managerial decision-making that can really make a difference. A clearer understanding of how marketers make decisions should therefore improve their quality.

Marketing was just a field of applied economics until around 1960, when behavioural sciences and quantitative models turned it into a discipline in its own right. However, while research into consumer behaviour grew by leaps and bounds, decision-making by marketing executives received only a fraction of the attention. It is time to rectify that.

After all, the quality of managerial decision-making is the single most

(what it costs); promotion (making the public aware of it); and place (sales channel). There are others, such as customer behaviour, competition and the economy. In the end, however, it is the marketing decision-maker who has to evaluate alternatives, evidence and uncertainties, and decide on marketing policy. Not surprisingly, marketers can deploy impressive personal assets based on market knowledge and a finely tuned intuition.

“How do you compare the expertise of a marketer trained in a fast-moving consumer industry to one trained to market airplanes?”

determining factor behind successful marketing management. Granted, there are many others that influence the outcomes of a marketing policy. For instance, the marketing mix: marketing instruments defined as product (type of offering and the value it delivers); price

Know thyself

However, in order to improve the effectiveness and quality of their decisions, marketers need to pay attention to how they make decisions, as well as to the choices of marketing techniques and support tools

available. This they can do by asking themselves a series of key questions (and subsequently responding to them) based on prevailing concepts, experiments and issues.

Relying on a unique combination of facts and reasoning, marketing management, it has often been said, is both a science and an art. The data part of marketing can be handled by sophisticated quantitative techniques. But, there is also a need for judgment and intuition to reconcile the huge number of factors influencing a particular decision; data models alone simply cannot identify the best decision.

This requires a combination of ‘head’ (models and analysis) and ‘heart’ (intuition and gut-feeling). Creativity also plays a part in thinking up new products and promotion campaigns. This unique mix of quantitative and qualitative elements has major implications for how marketing decisions are made.

Developments in the field of behavioural decision-making are helping to provide deeper insight into managerial decision-making. In particular, this involves investigating four key elements relevant to marketing: the dual-process model of decision-making; learning; emotions; and expertise.

Let me start with the dual-process model. Research defines



two fundamentally different cognitive systems that describe how people (including marketers) think and reason: an Intuitive System (also called System 1), which is instantaneous parallel and automatic; and an Analytical System (also called System 2), which is rule-based and is slow, serial, controlled and effortful.

Competency in marketing management requires learning on the spot, a lot of practice, and accumulating knowledge from experience. This is Intuitive System thinking. Marketing decision-making also involves manipulating such concepts as marketing-mix (to see how it affects sales), reasoning, developing decision alternatives, abstract thinking, and sometimes carrying out computations. This is what characterises Analytical System thinking.

Hard data, soft judgment

Importantly, you need to determine whether a particular approach – intuitive or analytical – will be successful. Here four marketing problem-solving modes (the first two are analytical and the last two intuitive) provide some guidance: optimising (looking for the best solution to a well-structured problem); reasoning (analysing the solution mentally through 'if-then' logic); analogising (use of past experience of similar situations); and creating (finding creative solutions to unstructured problems by using associations and divergent thinking).

Next, how do marketing decision-makers learn? Using an advertising campaign as an illustration, one manager may use specifics from past campaigns in designing new ones. This is called exemplar-based learning.

Another manager recalls instead key relationships between attributes – say advertising expenditures and the increase in sales – from past campaigns. This is called cue-abstraction learning.

It is also interesting to see how managers respond to computer-based Marketing Management Support Systems (MMSS). Let's imagine a system for designing new sales promotions that has a database holding previous sales promotions and their outcomes, and two user functions. The first one is to search in the database for similar sales promotion situations and find out what the company did then and the resulting outcomes.

The second function uses a model, which approximates past cases in the database, to run what-if simulations for the new sales promotion. Which one will the manager use in the learning process? And how do marketing managers learn most effectively under the following conditions: when they are accountable for their decision processes; or from the outcomes of their decisions; and when the tasks are simple or complex?

Emotions can help (for example, by sensing dangers), but also hurt (for example, by making people too risk-averse). In marketing decision-making, emotions have not been explored to any significant extent, ▶

Understanding marketing decision-making (continued)

by Berend Wierenga

making the evaluation of their effects in monetary terms on decision-making not possible. What can be said, however, is that emotions do play a role, especially under certain conditions, such as strong competitive pressure, negative public opinion, or internal company conflicts.

Managers often excel because of their expertise, the final element we will explore. It raises several key questions. Considering that to become an expert in a particular field requires a minimum of ten years of intensive training, along with exposure to, and activity within, the particular domain, what is the best way to create real marketing experts? Certainly this sort of training, exposure and activity is needed, but what is the best way of acquiring experience? Is in-depth and long-term exposure to a particular industry more effective than broad experience covering several industries?

Because expertise is usually limited to one domain, how do you compare the expertise of a marketer trained in a fast-moving consumer industry to one trained to market airplanes? Because of its recognition or priming nature, expertise is fast. Therefore, the interaction of expertise with time pressure is interesting. It may well be that expertise is most beneficial in situations with high time-pressure. And

how about the use of so-called expert systems in assisting decision-making? Here are some additional questions marketers could ask themselves:

- Are you using the right combination of Intuitive and Analytical System in your decision-making?
- The development of intuition is dependent on the feedback from the environment. Are you getting the type of feedback that helps to develop 'good' intuition?
- Exemplar-based learning means that you stay close to earlier experiences, which may lead to incremental behaviour. Are you susceptible to this type of potentially suboptimal behaviour?

Crucial next-step

Pursuing answers to all these questions and addressing these issues is not only an interesting academic challenge, but the results of this work will also improve the quality of marketing decision-making and thus boost the contribution of marketing to the performance of a company. More ought to be done, and for good reason. If behavioural researchers redirect just 20 per cent of their effort in marketing from consumer behaviour to managerial decision-making, the pay-off would be enormous.

Technology can also help. Interestingly, many business schools have state-of-the-art behavioural labs, and several researchers in marketing employ brain observation technologies (like functional magnetic resonance imaging or MRI) to study what goes on in the human brain during decision-making processes. In addition, modern marketing decision-makers are surrounded by information technology, making it relatively easy to observe and record their information-processing and communication activities. ■

Real-life decision-makers are essential for our research in managerial decision-making in marketing. If you are willing to participate in our experiments or surveys, please contact Prof. Berend Wierenga at [MAIL bwierenga@rsm.nl](mailto:bwierenga@rsm.nl).

This article draws its inspiration from the paper *Managerial decision making in marketing: the next research frontier*, which was written by Prof. Berend Wierenga and published in the *International Journal of Research in Marketing*, 28 (2011) 89-101.

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Coping with complexity in emerging markets

by Suzana B. Rodrigues

With low growth driving European and American businesses to faster-growing economies, how do these foreign companies handle the complex challenges they face in emerging markets?

Brazil and China, two BRIC economies, are prime examples of a widening gap between business needs for growth and the availability of resources. Both countries suffer from poor infrastructure and lack of skilled manpower. Economic and social environments are non-linear and therefore complex, not only because they change fast, but because there is also an imbalance in the macrostructure.

because of their 'foreignness', and their lack of understanding of business relationships and how to interact with the institutional system.

Understanding complexity

We find two main types of complexity in emerging markets: cognitive and relational. Cognitive complexity arises when there is difficulty in understanding the characteristics of a complex

inconsistency of information, creates high uncertainty among foreign firms.

The second type, relational complexity, arises from the lack of stability in partnerships, or low organisational commitment. A keen desire to get rich or succeed professionally makes it difficult for company or departmental managers to create an environment of co-operation and information sharing. Critically, a problem of trust might arise.

In some cases, these two types of complexities may combine, for example, when local licence-granting agencies have inconsistent policies, and when local partners cannot deliver key competencies.

As emerging markets grow, so do the number of firms offering similar goods and services, leading to large variations in quality, prices and reliability. Because many suppliers are new entrepreneurs who have discovered gaps in a given industry, many of them take advantage of institutional failures and inconsistent customer information to profit from fraud and fake products. These complexities reduce trust among market players.

As the number of opportunities increase, so does opportunism. The combination of inconsistent ethical behaviour of some businesses and their questionable capacity to deliver (associated with their sudden rise in profits) makes markets unpredictable

“Depending on size and influence, a company has three ways of coping with complexity: complexity reduction, absorption and mediation.”

While demand for goods and services is on the rise, these economies are confronted with serious educational and transport deficits. They suffer severe shortages of specialised labour in technical, engineering and management areas, which can only be resolved in the long run. Furthermore, a heterogeneous social and economic structure and problematic legal systems may impose further demands on foreign companies planning on operating there. These firms can also experience uncertainty

environment: how institutions function; business groups and the unfamiliar demands that they impose, and rules and regulations. Typically, information on emerging markets is insufficient and rules and laws are inconsistently applied due to an incomplete legal system and inefficient institutional enforcement. Consequently, firms cannot apply already-established procedures or extrapolate from past experience. This sort of complexity, caused by high levels of ambiguity or



and creates additional uncertainty through poor or non-delivery. This also causes problems with foreign investors.

In short, even though conventional wisdom views growth in a positive light, there is an important consequence and downside: increasing cognitive and relational complexity in emerging markets. So, how do foreign companies deal with it?

Handling complexity

Depending on size and influence, a company has three ways of coping with complexity: complexity reduction, absorption and mediation. The first, complexity reduction, refers to the direct action a company can take to simplify external complexity. When the company is relatively powerful and can actively influence its environment, such as a multinational, it is likely that its managers will use that power to reduce both cognitive and relational complexity in their dealings with the environment.

Relational complexity can be reduced by lobbying governments to create a more regulated environment through legislation and its effective enforcement; and by developing political capital that is used to gain a privileged market position. Several examples can be found among Chinese investments in Africa, where Chinese companies reduce uncertainty

through favourable understandings with host governments.

In parallel, companies can reduce complexity by locking local companies into the dominant business through taking sole ownership, or at least a controlling interest. Firms can reduce cognitive complexity by replicating their own internal environment in host countries, by introducing tried-and-tested routines, standards and ethical procedures, thus avoiding the relational complexity of shared decision-making and management.

When a company cannot dominate its environment and there is a balance of power among the players and government, complexity absorption may prove more effective. Here organisational actors endeavour to understand and work with cognitive complexity by entering into multiple relationships within the system. Choosing another brand name for the subsidiary helps the company integrate into the local environment and so does the choice of local suppliers. Surrogate brand names also help protect the core business from threats that affect its reputation.

Smaller firms, on the other hand, may establish their business abroad with those that they trust or had business dealings with in the past. Their lack of power, influence and resources attracts them to the third mode of engagement,

complexity mediation, where they accommodate a complex environment without absorbing complexity or reducing it to any significant extent. Mediation contrasts with both reduction and absorption in that firms attempt to cope with environmental complexity by relying on other parties.

A final thought. Despite their complexity, emerging economies may offer unprecedented opportunities for a company to grow fast. The challenge is in developing and managing strategies to mitigate risks and at the same time take advantage of opportunities. Crucially, this requires diligence in understanding the local business environment – including the politics, culture, pitfalls and barriers – and then finding mutually beneficial ways to adapt and interact. ■

This article is based on the paper *How organizations engage with external complexity: a political action perspective* written by John Child and Suzana B. Rodrigues and published in *Organization Studies* 2011 32: 803.

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The perils of pursuing profit

by Michel Lander

A heightened focus on profit at traditional professional service firms will almost inevitably lead to deterioration in individual and collective professional behaviour at the larger of those firms. There are valuable lessons to be learned here that could be applied in other industry sectors.

Professional service firms (PSFs) form an integral part of the contemporary knowledge-based economy. They are among the most affluent business enterprises, can be considered knowledge engines and have a public professional objective: serving vulnerable client and third party interests.

PSFs such as accountants and lawyers are organisations that are distinct from the rest of the corporate

gain and self-interest this could be quite detrimental for professional behaviour.

Changes in economic and social trends, government policies, and client preferences have led to the spread of a commercial ethos in the professions, which challenges traditional professional practices (for which the term P2 is used as convenient shorthand).

The deregulation of these industries is affecting the pillars upon which

see the need for that trade-off. The principal emphasis has shifted away from displaying professionalism and putting the client's needs first and towards generating profit.

Many PSFs are now adopting face-changing strategies and practices, and are moving in the direction of a new organisational template coined the Managed Professional Business (MPB). The reality is that professional service firms face a choice between focusing on generating profit or delivering high quality client-driven service. Striking a balance between the two is difficult.

The findings outlined in my PhD thesis *Profits or Professionalism: On Designing Professional Service Firms*, call into question whether the entire accounting profession has changed from the trustee to the commercial logic. Although mid-tier firms are similarly confronted with conflicting demands of trustee and commercial logic, the structures and procedures resulting from this clash are different as compared to those documented with the big four global firms. Mid-tier firms pick and choose between components of strategic and structural organisational responses.

These differences are due to the continued influence of the professional logic, which makes both partner and non-partnered accountants unwilling

“Large firms are sacrificing professionalism and client care in their pursuit of profit, creating the conditions in which events such as the Enron collapse can occur.”

world. Like any commercial organisation, they need to make a profit, but they need to do so while fulfilling a fiduciary duty to the public at large. When these ideals of service and public welfare are subordinated in favour of commercial

they have been built, increasing the focus on competition and coping with the concomitant pressures on price. There is an inherent trade-off that they need to make between professionalism and profit, and I am not sure that they



to compromise their professional norms. Resistance to change within these firms thus results in differing organisational responses.

Traditional professional service firms are distinguished by their preference for informal supervision, collegiate decision-making and an emphasis on service quality and standards.

My findings further suggest that the type of long-established informal practices that feature predominantly in PSFs of the P2-type are better attuned to the specific governance challenges of PSFs than the more formal practices characterizing MPB-like PSFs. Presumably, this is because these informal practices are better suited to deal with hard to observe and difficult to monitor professional behaviours than more formal organisational practices.

The impact of deciding to pursue greater profit can be immense. It leads to the introduction of formal supervision instead of informal supervision, and directed decision-making instead of collegiate decision-making.

Large professional service firms which focus on formal governance and corporate strategy will increase their performance. But they will also increase the propensity towards misbehaviour. In some cases this can manifest itself in charging for hours not worked, or charging for senior

fees rather than junior fees. Evidence of client dissatisfaction arising from such practices is available in the form of complaints submitted to disciplinary courts.

In this environment, collegial supervision and the time to fulfil professional duties diligently will be a thing of the past; partners will find that while they nominally still have a voice, that voice will in practice be quieter and less listened to than was historically the case.

My research leads me, then, to issue an important warning to readers. Once a company passes a certain threshold in terms of scale, collegiate decision-making ceases to be the norm. Formal and informal governance cannot co-exist where firms are chasing profit. Collegiate decision-making takes too long, thus reducing the hours that can be worked for, and charged to, clients. Informal governance becomes costly and is often replaced by formal governance.

In conclusion, my research shows that mid-sized accounting firms and law firms are significantly more focused on service than on profit. Large firms are

sacrificing professionalism and client care in their pursuit of profit, creating the conditions in which events such as the Enron collapse can occur.

This leads me to end by making three suggestions which legal and accounting firms might find time to consider when reviewing their future development. It is possible that the price of chasing profit is just too high for the broader good. It is possible that the firms concerned have forgotten that theirs is a professional industry benefitting from special privileges, from which clients expect the servicing of complex transactions. Finally, and perhaps most poignantly, their civic duty seems to have been relegated irrevocably in importance in the pursuit of profit. ■

Michel's PhD dissertation *Profits or Professionalism: On Designing Professional Service Firms*, was published as part of the Erasmus Research Institute of Management (ERIM) PhD Series, Research in Management. [WEB http://repub.eur.nl/res/pub/30682/](http://repub.eur.nl/res/pub/30682/). During the course of his research Michel received funding from AXA Research Fund.

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Co-operatives and channel governance

by George Hendrikse

The inference behind the economic principle known as Gresham's Law is that 'bad money drives out good money'. The Greenery, a €1bn-plus annual turnover fruit and vegetable processing co-operative in the Netherlands, found this to be almost literally true.

In my recent paper, *Pooling, Access, and Countervailing Power in Channel Governance*, I review how a longstanding traditional policy of paying its producer members by quantity rather than quality, threatened not only the image of The Greenery, but also its very existence.

I also consider how a willingness to change its by-laws and policies on payment in reaction to that threat saved the business. The change in emphasis that shifted the distribution of surpluses, rewarding higher quality producers more than lower

fascinating field. Main topics are the ownership of the enterprise, hiring the right people, paying for A while hoping for B, task and job design, and alignment in organisations. When considering the question of supply chain governance, a key question is: which party should own which part of the chain? Candidates are farmers, intermediaries, retailers and consumers.

The best-known structure is the publicly owned stock market company, but most organisations are not publicly listed or owned

foundations. My own longstanding special interest is in organisations owned by suppliers, especially agricultural co-operatives.

The Greenery B.V. is one of the leading companies in Europe in the fruit and vegetable sector. Its main activity is to provide a complete range of fruits and vegetables to supermarket chains in Europe, North America and the Far East throughout the year. Other major target groups are wholesale businesses, catering companies and industrial processing companies. The company has some 2,500 employees, while 1,500 producers own its shares. They are members of the horticultural co-operative Coforta U.A. and they market all their products via The Greenery.

The Greenery has gone through various governance structure changes. It started as a merger between nine regional fruit and vegetable auction co-operatives in December 1996. They combined all their assets and activities into Voedingstuinbouw Nederland (VTN). VTN is the 100 per cent shareholder of The Greenery. The organisation integrated forward by acquiring the fresh produce wholesalers Dutch Van Dijk Delft Group and the Fresh Produce Division of Perkins Food plc, a UK-based wholesaler in 1998.

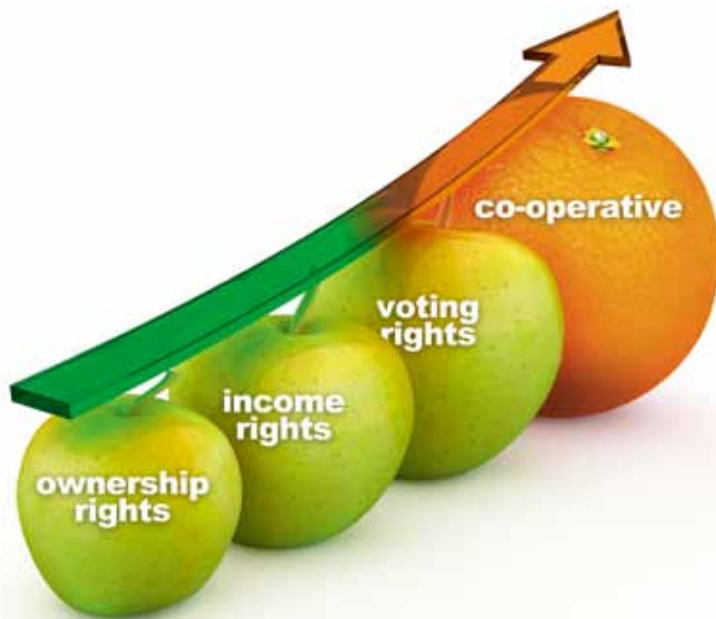
“Many co-operatives nowadays spend considerable effort in redesigning their income rights in terms of developing member benefit programmes.”

quality ones, means The Greenery's pie is today larger, delivering a win-win scenario.

Economics of organisations

The economics of organisations is a

by external shareholders. Family-owned entrepreneurial companies, for instance, fall into this category. Many organisations, such as hospitals and universities, have no owners in the conventional sense. They are



It is possible to cite a number of good reasons for co-ops to form. If small-scale farmers join forces to deal with retailers, it increases their joint bargaining power with those retailers. This is an important consideration in the case of perishable goods. Ownership of a processing company gives access to the processing state of the cycle, further increasing bargaining power. Some co-ops have become very large organisations in their own right, turning over billions of dollars.

The basics of ownership

Ownership is a crude instrument to align interests. There is more to enterprises than their ownership structure. Nowadays enterprises are characterised in terms of their governance structure, specifying the structure of ownership, decision, and income rights. The ownership rights specify who formally owns the enterprise. For example, farmers are the owners of an agricultural co-operative.

Decision rights specify who may take decisions on the strategies and policies of the organisation, as well as on the use of assets and thereby on

the employment of people working with these assets.

Decision rights include the allocation of authority (delegation, centralisation), decision control (ratification, monitoring), decision management (initiation, implementation), task design, conflict resolution, and choosing enforcement mechanisms.

Income rights are rights to the (monetary) benefits and costs resulting from the activities of the organisation. Income rights are reflected in the composition of cost and payment schemes, thereby creating the incentive system. Examples of income rights in co-operatives are direct and indirect benefits of patronage, cost and benefit allocation schemes like pooling arrangements, and the compensation package of the members of the management team.

Many co-operatives nowadays spend considerable effort in redesigning their income rights in terms of developing member benefit programmes. Examples are quantity discounts, quality premiums, service at cost, offering favourable possibilities to supply financial funds for specific members, and supplying services

tailored to the broader interests of specific members. It is in line with the normative implication of the increasing heterogeneity for the efficiency of traditional cooperatives that the impact of the collective features has to be reduced.

Income rights

Even the best-laid plans of mice and man, however, are subject to change, and change came to affect The Greenery, adversely, when the inadequacies of its payment pooling structure began to become clear. Various large growers left The Greenery to launch their own product-specific bargaining associations over the next few years. Finally, various bargaining associations merged again with The Greenery after the introduction of member benefit programmes.

As I note in my paper, pooling is an important aspect in many organisations. In his 1998 paper, researcher J. Nilsson observes that the principle of equal treatment within agricultural co-operatives is traditionally strong. For example, prices are not always differentiated based on quality and quantity, and member control, eg, the general rule is that all members have equal voting rights. The economic impact of equal treatment is that revenues and ▶

Co-operatives and channel governance (continued)

by George Hendrikse

costs are allocated to a certain extent independent of quantity and/or quality.

The increasing grower heterogeneity poses also a challenge for traditional grower organisations because various aspects of these governance structures are tailored towards homogeneous members. Heterogeneous co-operatives have difficulties in keeping highly innovative growers. In the case of The Greenery, a number of large growers left due to the cross-subsidisation of small growers.

Innovative growers started product-specific bargaining associations. There were also some innovative growers leaving the co-operative in order to form bargaining associations and marketing co-operatives to advance their specific interests. They felt that marketing efforts could be improved to highlight their products.

Organisations can change internal policies to keep high quality members. Adjusting the pooling scheme brought farmers back. The Greenery moved away from its pooling practice to tailor services to different member groups as far as possible. To bring the better producers back, The Greenery changed its policy to one based on quality as well as quantity. If you pay the producers of bad cucumbers the same as you pay the producers of good cucumbers, producers will leave. This is the fruit

and veg version of Gresham's Law, referred to earlier.

Positive image

Co-operatives emerge as a response to market failure. That is, the market does not provide certain products and services. Once co-ops came into existence, they largely enjoyed a positive image because of their communitarian philosophy, rooted in the determination to maximise price and profit for the ultimate suppliers of the goods being sold, rather than for intermediaries such as wholesale buyers and retail sellers.

Was that image damaged by the events that unfolded at The Greenery? It certainly came under threat. The management took action to rectify the situation and keep the growers inside The Greenery to maintain bargaining power. They changed the remuneration policy to place more emphasis on quality than on quantity.

Today, co-op payment policies are such that sometimes only high quality producers tend to be members. They tend to be too demanding for low quality producers. In this scenario, the distribution of any surplus rewards the higher quality producers more than lower quality producers. The pie is larger and the division of the pie has changed. Various questions surrounding the optimum

form of ownership structure and channel governance remain unanswered, however.

Around one-third of world production today goes through co-ops. Which means two-thirds does not. Which is best? Ownership and income rights have been addressed, but decision rights have not. Bijman *et al.* (2012) address decision rights by distinguishing various board models in co-operatives. Successful co-operatives accommodate the diverging interests of their membership and the co-operative enterprise in one organisation. This is done by doing justice to the specific interests of the stakeholders in the design of coherent ownership, decision, and income rights. ■

This article draws its inspiration from the paper *Pooling, Access, and Countervailing Power in Channel Governance*, which was written by George W.J. Hendrikse and published in *Management Science*, 2011, 57(9), 1692-2002.

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