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LEIZ CASE STUDY #6

# Organisational Transformation of Network Organisations

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LEIZ CASE STUDY SERIES

# Relational Economics in Practice. An Introduction and User Guide

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The research program of relational economics constitutes the core of the Leadership Excellence Institute Zeppelin | LEIZ. Building on the publications of the Springer series "Relational Economics and Organization Governance" and the annual conferences of the emerging relational economic community, a theory is developing and establishing itself that represents a paradigm shift in the field of economics: the unit of analysis is no longer the actor or the market, but the relational transaction in its complex, polyvalent, uncertain, context- and time-dependent constitution. The aim behind this is to come closer to an understanding of the real conditions and consequences of economic action. For this reason, and in view of the fact that the corresponding conceptual description tools are now available, it seems highly plausible and expedient to focus even more on examples of application. If relational economics has the declared aim of depicting economic realities as precisely as possible, then such an undertaking of practical application should not only be productive in terms of concrete recommendations for decisions, but should also, in turn, further confirm the relevance of the theoretical concept.

The series of case studies presented here aims to offer nothing more and nothing less: We invite students, practitioners and colleagues to join us in trying out what relational economics has to offer in its application to real case studies. The analytical tools available for this purpose are briefly presented below in order to provide our readers with a kind of instruction manual without implying that real-world complexity can be dealt with in a one-size-fits-all manner. Rather, the analytical steps proposed here are intended to help describe a relational transaction as a basis for then working out more context-

and time-specific options for action. This is carried out using the stakeholder model as the basic analytical structure, which is complemented in the respective cases by further case-specific methods derived from the toolbox of relational economics.

The attitude of a thorough and competent detective is required if one really wants to capture and describe a relational transaction appropriately: identifying and analysing the stakeholders involved, their resources and interests, and above all their mutual interaction, which, in turn, changes them, play a central role before further theoretical building blocks of relational economics can be applied. Accordingly, this analysis step also forms the common denominator with which the analysis of all the case studies collected here finds its starting point. For this reason, the stakeholder model is placed in the foreground in this user guide and is now briefly explained - other models are then introduced in the individual case studies and discussed in the application of these cases.

## Stakeholder Model of Relational Decision Making

The theory of relational economics defines a firm as a nexus of stakeholder interests and invested stakeholder resources and corporate action via relational transactions that combine, in a cooperative and productive manner, the interests and resources of the stakeholders involved. The fact that, in particular, this takes place across cultural and sectoral boundaries is emphasised here and is related to the claim to take the real complexity and uncertainty of economic activity into account – thinking, for example, of global value creation networks or of the requirements from the ESG discussion.

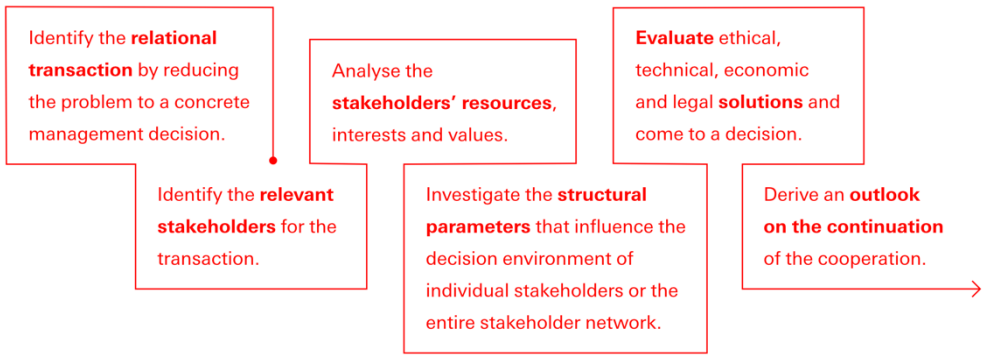
In order to derive a management decision in a specific constellation – for example, in the situations depicted in the LEIZ case studies – the stakeholder model provides the basic framework (Wieland 2020: 97ff.) and is presented here in a condensed form for the given purpose. The application of this model reveals the time- and context-specific microstructures of the relational processes and structures. It comprises six steps:

1. Reducing the problem to a concrete management decision. This concrete management decision ideally is a clearly narrowed down yes/no/alternative decision. This decision is the relational transaction that is to be analysed in the subsequent steps.
2. Identifying the relevant stakeholders with reference to the transaction. This includes the identification and prioritisation of the involved individual or collective stakeholders. Depending on the transaction, the stakeholders can be, for example, employees, management, customers, suppliers, investors, competitors, NGOs, political institutions or the public.
3. Analysing the respective stakeholder resources, interests and values. This entails a thorough look at the polyvalent constitution and motivation of each stakeholder. Such resources and interests could be, for example, economic, political, moral or professional, and the values can be, for example, performance values, communication values, cooperation values or moral values, that need to be combined and balanced.
4. Investigating the problem along the structure of the decision environment. This requires checking the relational transaction in-depth via the following eight structural parameters (Wieland 2020: 99):
    I. Decision-making stress (for example, due to political or media pressure)
    II. Intrapersonal values conflicts (for example, conflicting values arising from role-based expectations)
    III. Inter-organisational values conflicts (for example, ideals held by the collective actors that are non-negotiable for them)
    IV. Intercultural values conflicts (for example, differences in the moral doctrines of different groups)
    V. Information deficits (for example, regarding the scope and consequences of an assigned task)
    VI. Communication deficits (for example, resulting from the type of communication between the network partners)
    VII. Responsibility diffusion (for example, who is responsible for creating and solving a given problem and on what grounds)
    VIII. Rules deficits (for example, resulting from the lack of private or state regulation, or from its unenforceability).

5. **Evaluating ethical, technical, economic and legal solutions and reaching a decision**. In most cases, this decision combines ethical, technical, economic and legal approaches by evaluating the transaction-specific advantages and disadvantages of the available decision logics and considering their interdependency.
6. **Deriving an outlook concerning the continuation of the cooperation.** The question here is what new commonalities have been formed and to what extent the stakeholders involved have changed as a result of the transaction (Baumann Montecinos 2022).

FIGURE 0

An outline of what such an analysis could look like in general terms




Source: own illustration.

Thus, the foundations have been laid for working on the LEIZ case studies. We will be delighted if this material is used to promote learning and exploration of relational economics, particularly in its strength of practical application. Feedback from and exchanges between lecturers would be more than welcome.

## Literature

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LEIZ CASE STUDY #6

# Organisational Transformation of Network Organisations

Lukas Belser

## Introduction

The focus of this case study lies on organisational transformation and management of network organisations. The case study describes the situation of a manager from a strategic corporate development department who has the task of redeveloping the company's business model while considering challenges and opportunities within the network. The aim of the case study is to elaborate on the managerial complexity of today's globalised network organisations and how to manage such kinds of structure adequately. Furthermore, in the discussion, it is highlighted which crucial circumstances outlined in the description need to be considered as well as which kind of theoretical concepts, such as the resource and relational view of the firm and governance structures, can be applied in order to discuss the given questions effectively.

## Case Description

Frank Freuding is Head of Strategic Corporate Development at The Plant & Machine Engineering Company. He works together with one co-worker as well as a trainee. He is responsible for strategy building and strategic projects within the company. Part of the management team is of the opinion that the company needs to readjust its business model in order to stay competitive in a rapidly changing market. Frank Freuding is responsible for defining hurdles, solutions, and an execution approach to achieve this goal.

The Plant & Machine Engineering Company is part of a holding company structure, which consists of six strategic business units (SBUs). The Plant & Machine Engineering Company is one of these SBUs. While The Plant & Machine Engineering Company focuses on engineering plant and machines, the other five SBUs have a different business model. They are engaged in sales, maintenance, and repair of large-scale construction machinery in European and Central-Asian Markets. They do not engineer the construction machinery themselves but purchase them from another company. The annual turnover of the whole group ranges between 3-4 billion euros. The EBT of the individual SBUs ranges between 1 and 80 million euros. The whole group employs approximately 10,000 employees.

The Plant & Machine Engineering Company employs around 1,600 employees with an annual turnover of around 300-400 million euros. The yearly EBT of The Plant & Machine Engineering Company ranges between 2 – 7 million euros, depending on the project order volume. The Plant & Machine Engineering Company owns 13 subsidiaries in 13 different countries, dispersed globally over four continents. Each subsidiary has between 1 - 5 locations (e.g., offices, production sites). Two of these subsidiaries are joint ventures, one of which The Plant & Machine Engineering Company owns 51% of the shares and a local family the remaining 49%. Of the other joint venture, The Plant & Machine Engineering Company owns 40% of the shares, while a state-owned and family-run company in the respective country owns the remaining 60%. The other subsidiaries belong to The Plant & Machine Engineering Company entirely.

The Plant & Machine Engineering Company is active in four industry sectors: Polyolefin plants, Rubber plants, Performance Materials, and Food Processing. The value proposition of The Plant & Machine Engineering Company consists of three dimensions: projects, products, and services. The dimension “projects” describes the plant engineering projects that The Plant & Machine Engineering Company executes globally. They plan and engineer entire plants and overlook the construction process of these plants on site. Every plant is engineered individually to customer requirements. Even though the plants in one industry sector may be partly similar, there are large varieties regarding location, size, local restrictions, individual requirements, as well as other factors. This makes every project unique.

Besides that, The Plant & Machine Engineering Company has a product portfolio of different machines, mechanical applications, and a few small software applications, which are mostly sold along with the entire plant construction project. The third dimension, “services”, consists of spare parts selling and repairing and modernising existing plants. The dimension “projects” is responsible for 90% of the turnover, and “products” and “services” for roughly 5% each.

Originally founded in around 1900 in a small town in southern Germany, The Plant & Machine Engineering Company overcame several crises and grew constantly. Besides its own success in the market, M&A activities, in particular, led to rapid growth beginning in the 1990s. Since then, The Plant & Machine Engineering Company has acquired 11 small-sized companies and 1 medium-sized company and hence enlarged its product portfolio as well as its customer base. The global expansion began by establishing sales offices in foreign markets or by acquiring local companies. Some of the sales offices developed into more mature locations with additional capacities (e.g., engineering, planning) besides sales.

The Plant & Machine Engineering Company has changed its business model several times in recent decades. In the early years, the Plant & Machine Engineering Company solely engineered and built mechanical, mostly metal-based products such as industrial silos and small machines for various purposes. With growing competition from different markets, these products no longer generate the desired return. Especially higher costs of production in Germany, but also an increasing cost-quality ratio from competitors in European and Asian markets led to the need for a change of strategy. Back then, the management concluded that the internal key resources were the mechanical engineering skills of the company’s employees. Hence, the value proposition was changed from mechanical engineering and producing mechanical products to mechanical engineering as a service.

The Plant & Machine Engineering Company successfully changed its main value proposition into providing mechanical engineering as a service for clients of all kinds of engineering for all industry sectors while keeping its mechanical product portfolio in place on a smaller scale. Over the years, the new business model was challenged by globally decreasing prices for engineering hours and a growing number of competitors with a similar value proposition. Therefore, the need for yet another re-evaluation of

the business model became urgently necessary. The decision was made not to offer engineering hours for any kind of client request anymore, but to focus on one specific area of mechanical engineering.

The Plant & Machine Engineering Company again changed its business model to being a solution provider in the plant building industry. From now on, the company focuses on engineering entire plants and governing the project execution management of building these plants. In doing so, the focus was and still is on plants where different materials are being pneumatically conveyed. These kinds of plants are used in different industry sectors with varying conditions of framework and requirements (e.g., tyre production, food processing). The focus was on only one industry sector in the beginning, expanding to a total of four different industry sectors today.

## Challenges

The engineering design of plants evolves constantly, and with a growing need for automation and software solutions, it is no longer sufficient for a plant to be built to high mechanical quality standards. For plant operators, it has become more and more important to control the processes in the running plant (for different reasons) digitally and implement predictive maintenance solutions in order to reduce production downtime costs. Solution providers like the Plant & Machine Engineering Company must adapt to this trend in order not to be pushed out of the market. To date, most software engineering has been outsourced to a software provider since this part of the plant has not been assessed as critically important for a long time. This assessment has now been reversed. Returns in aftersales have become increasingly important, and without owning the software and automation applications of the plant, this has become difficult. Hence, the business model needs a shift to address these issues.

Software engineers are very rare and expensive. In some labour markets such as Germany, it is almost impossible to build up large internal capacities for automation and software engineering. Yet, combined globally, the Plant & Machine Engineering Company has internal access to a decent amount of these capacities. For example, the joint ventures in which the Plant & Machine Engineering Company owns 51% (see commentary) is focused on building software applications and automation products.

But also, other subsidiaries have considerable knowledge and capacities in this respect. Hence, some of the management team are of the opinion that the corporate intra-organizational network, consisting of different subsidiaries, needs to be more aligned in order to work more closely together on the long-term goal of digital transformation.

Different cultural backgrounds, different technical standards, fuzzy strategic goals and lack of trust between different subsidiaries are some of the pain points. Additionally, the corporate intra-organizational network is shaped like a star, with a strong headquarters at the centre and a market-based governance structure to manage the subsidiaries. Hence, there seems to be a lack of incentives to work closely together on long-term goals for each subsidiary.

Frank Freuding has already started a global software & automation summit, including all managing directors and vice presidents, which takes place regularly. He wanted to discuss the hurdles and opportunities of developing the company's new business model. Unfortunately, the different standpoints seem to be incompatible. Some strongly support the idea; others don't. Everybody has valid evidence to support his or her point of view. Frank Freuding has taken a break in conducting his global software & automation summit and needs to come up with clearer goals and an execution strategy.

## Questions

Discuss the organisational transformation of The Plant & Machine Engineering Company into a functioning global network. Take topics such as business model innovation, controlling, governance structures, and internal/external resources into consideration and address the following three interconnected outlines:

1. How can the new business model realistically be structured? Create a systematic draft and provide arguments that Frank Freuding can use to convince the board (Take possible challenges and opportunities into account).
2. How can the intra-organisational network be aligned, in order to work on common strategic goals and to access critical resources (e.g., market access, talent, business partners, etc.)? What important dimensions of alignment should be taken into account? Discuss the pros and cons of different governance structures applied in order to achieve an alignment.

3. Critically discuss centralised or decentralised organisational approaches, also provide specific examples based on your analysis.

## Discussion

For the discussion of the questions, different governance structures and their inherent strengths and weaknesses need to be considered. Powell (1990) gives the relevant overview:

FIGURE 1

### Comparison of Governance Structures

| | Forms | | |
|---|---|---|---|
| **Key features** | **Market** | **Hierarchy** | **Network** |
| Normative basis | Contract – property rights | Employment relationship | Complementary strengths |
| Means of communication | Prices | Routines | Relational |
| Methods of conflict resolution | Haggling – resort to courts for enforcement | Administrative fiat-supervision | Norm of reciprocity – reputational concerns |
| Degree of flexibility | High | Low | Medium |
| Amount of commitment among the parties | Low | Medium to high | Medium to high |
| Tone or climate | Precision and/or suspicion | Formal, bureaucratic | Open-ended, mutual benefits |
| Actor preferences or choices | Independent | Dependent | Interdependent |
| Mixing of forms | Repeat transactions (Geertz 1978)<br>Contracts as hierarchical documents (Stinchcombe 1985) | Informal organization (Dalton 1957)<br>Market-like features: profit centers, transfer pricing (Eccles 1985) | Status hierarchies<br>Multiple partners<br>Formal rules |

Source: Powell 1990: 300.

To manage the network properly a mix of governance structures is applied. It is important to consider the different kinds of contractual relationship the company has with its subsidiaries.

It becomes clear that there are different views of the current situation within the management board of The Plant & Machine Engineering Company. One can assume that there are conservative voices that try to convince other board members to focus solely on mechanical engineering – the field of work in which the company has the most experience and longest history. Members of the management board who are of this opinion probably highlight risks such as not being able to deliver the same quality standards in software solutions from the start as the ones in mechanical engineering. Members of the management board who are of the opposite opinion might mostly highlight business opportunities and future engineering developments while viewing the opposing position as old-fashioned and not sufficiently visionary. Even though top management has made decisions that can be executed through hierarchical structures, for Frank Freuding it is becoming crucial to convince board members who have opposite opinions constantly. It is important to mediate the different viewpoints in order to recognise and discuss risks, hurdles and opportunities and to align the board on the strategic goal. This is an important step in order to work along similar lines. Therefore, Frank Freuding should convene a steering committee responsible for guiding the process and creating a forum for open and guided exchange between relevant stakeholders. Relevant stakeholders can be defined by using a stakeholder analysis.

The network of the Plant & Machine Engineering Company is highly complex. On the one hand the company is embedded in the holding company structure as one of six SBUs. The position of the Plant & Machine Engineering Company within this structure needs to be considered. It appears that the Plant & Machine Engineering Company has a slightly different business model and probably a different company culture than most of the rest of the holding company structure. When considering the EBT of the individual SBUs, the range is widely distributed between 1 and 80 million euros. The Plant & Machine Engineering Company does not contribute so much per employee when one considers its EBT. This could be a source of tension within the holding company and between the SBUs. Also, one should consider that the EBT of the Plant & Machine Engineering Company ranges between 2-7 million euros, which is quite wide.

This can be due to the business model of executing large-scale projects. This means that, while in one year, there are a few large-scale projects, in the next year, there are not because of market changes or other reasons. Hence, it becomes difficult to maintain cash flow and to retain employees, who might be needed for another year if the market situation changes again in the Plant & Machine Engineering Company's favour. This current situation on the costs and earnings side should be taken into account when thinking about changes to the business model and management. On the other hand, the Plant & Machine Engineering Company is embedded in its internal network of subsidiaries and joint ventures, which are dispersed globally. There are different kinds of shareholders in the joint ventures in which the Plant & Machine Engineering Company owns shares. These shareholders might play important roles, especially because one of the joint ventures has larger amounts of software development capacities that are important in order to achieve the goal of changing the business model to a stronger software focus. The other joint venture is partly owned by the state in which the joint venture is located. It is not clear in which country the joint venture is located. Nevertheless, it is obligatory to form these kinds of joint ventures when entering the Chinese market, for example. Since most German machinery companies are active in the Chinese market, it can be assumed that this joint venture might be in the People's Republic of China. Risks such as intellectual property theft need to be considered when defining members of the steering committee or when thinking about the open exchange of technological ideas.

The value proposition of the Plant & Machine Engineering Company consists of three dimensions: projects, products and services. When looking at the percentages of turnover divided by dimension, it becomes clear that products and services provide only a small percentage. Service dimension could be a possible tool to stabilize cash flow on the one hand as well as enhance total profits. Since projects make up 90% of the turnover it becomes clear why the turnover varies so widely from year to year. When leveraging the service dimension, Frank Freuding could also achieve a stronger customer relationship through a deeper connection.

The company was founded in the early 1990s in southern Germany and therefore has a long history. This can be an argument for product quality, a strategic long-term view and the ability to overcome challenges. On the other hand, this can also be a heavy burden when planning to fundamentally change an organisation. Path dependencies in

business, such as customer base, development knowledge or local embeddedness, can be hard to overcome. The rapid growth through M&A activities may be a reason for success and current market share. On the other hand, rapid growth is likely to cause post-merger integration issues such as non-aligned product portfolios, different product development standards, different corporate cultures, and a lack of knowledge exchange.

When thinking of a business model which can be applied it can be useful to use a business model canvas or similar concepts to map the current business situation in order to point out possibilities for adjustment. By building on such a conceptual approach, it becomes clearer what kind of key resources are available and which need to be acquired. In order to achieve this on a theoretical basis, one should consider taking one of the following approaches into consideration:

FIGURE 2

## Comparison of Resource Based View and Relational View

| Dimensions | Resource Based View of the Firm | Relational View of the Firm |
|---|---|---|
| Unit of analysis | Firm | Pair or network of firms |
| Primary source of supernormal profit returns | \| Scarce physical resources (e.g., land, raw material inputs)<br>\| Human resources/know-how (e.g., managerial talent)<br>\| Technical resources (e.g., process technology)<br>\| Financial resources<br>\| Intangible resources (e.g., reputation) | \| Relation-specific investments<br>\| Interfirm knowledge-sharing routines<br>\| Complementary resource endowments<br>\| Effective governance |
| Mechanisms that preserve profits | Firm-level barriers to imitation<br>\| Resource scarcity/property rights<br>\| Causal ambiguity<br>\| Time compression diseconomies<br>\| Asset stock interconnectedness | Dyadic/network barriers to imitation<br>\| Causal ambiguity<br>\| Time compression diseconomies<br>\| Interorganizational asset stock interconnectedness<br>\| Partner scarcity<br>\| Resource indivisibility<br>\| Institutional environment |
| Ownership/control of rent-generating process/resources | Individual Firm | Collective (with trading partners) |

Source: Dyer & Singh 1998: 674.

Especially in the case of network organisations, the relational view of the firm can provide a solid baseline in order to develop strategic goals.

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## Keywords

Organisational governance, network governance, transformation management, strategic corporate development, relational view of the firm

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