Social Capital, Dynamic Capabilities and Strategic Flexibility in Transition Economies

Thaung Han[a], Fernando Parra[b], Joseph O'Connor, Ph.D.[c],
College of Business Administration, University of Texas at El Paso, El Paso, TX 79968
[a]than@utep.edu, [b]parra@utep.edu, [c]joconnor@utep.edu

Abstract

We investigate social capital, dynamic capabilities and strategic flexibility and their respective effects on the performance of firms located in transition economies. Borrowing from the resource–based[1] and industry-based[2]views of the firm, this study integrates and extends the existent literature using data from 100 firms in a transition economy that has been economically sanctioned by the international community: Myanmar. While the literature has concentrated in researching developed economies where firms operate on mostly stable socioeconomic and political institutions, this paper aims to develop in-depth understanding of social capital, dynamic capabilities and strategic flexibility to develop firms' competitive advantages and performance.

We posit that a firm must use social capital, as a means to obtain better business opportunities and hedge for market risks while applying dynamic capabilities in order to achieve and sustain competitive advantages and superior performance. In addition, we argue that a firm must also remain strategically flexible to weather turbulent socioeconomic and political forces affecting a transitional economy. Adapting from previously grounded scales in the literature [3,4,5,6,7,8,9] we describe our research plan on obtaining data from this eminently-emerging country recently highlighted by its political restructuring by surveying and interviewing 100 medium-to-large-sized firms across the country from manufacturing and service industries, including private and state-owned enterprises, foreign joint ventures and multi-national corporations.

Keywords: International Business, Social Capital, Strategic Flexibility, Dynamic Capabilities, Resource-Based View, Economic Sanctions, Myanmar, Firm Performance

Introduction

Achieving and sustaining competitive advantages continues to be of critical significance for international business (IB) practitioners and scholars alike. The IB literature, which is mostly anchored in the resource-based[1] and the industry-based [2] views of the firm, has been driven by research that is based on relatively stable, market-based institutions in major countries such as the U.S.). Yet, the last few decades of research have also shown that there are significant differences among the institutions that support economic activity in developed countries[10]; these socio-political differences are even more pronounced when compared to emerging countries[11]. As such, there is an issue of paradigm generalizability and limitation on the development of theory building [3].

Given these volatile institutional differences, we suggest that social capital, dynamic capabilities and strategic flexibility must be used by firms in emerging countries to hedge for

risks and achieve international competitiveness. The purpose of this paper is to investigate the effect of such strategic resources on a firm's ability to sustain core competencies in the presence of volatile external environments. This paper also aims to integrate the existing theories of international businesson the effective utilization of managerial network capital and adjustments of firm strategy. We argue that an international business strategy research focusing on firms in a transition economy, specifically under economic sanctions, could provide both theoretical contribution and practical implications for management by extending the existing theoretical and practical knowledge of international business management.

Research Context: Myanmar

Myanmaris a member of the Association of South East Asian Nations (ASEAN)strategically located between two vast emerging economies and political power houses China and India. Given alleged civil rights violations by the military crackdown in 1988 along with the military regime's refusal to honor election results in 1990, the U.S and the European Union, and to a lesser degree by Australia and Japan since 1997, placed economic embargoes on Myanmar. While firms from China, India, Russia and neighboringASEAN countries like Thailand, Singapore and Malaysia filled up the economic and trade vacuum left by multi-national corporations (MNCs) from the United States and the EU countries, the resulting economic vacuum and political isolation have placed this country in obscurity for most of the last two decades, especially for scholarly research. Transition economies, such as Myanmar, are generally characterized by the absence institutions and property rights of western standards, inefficient and undeveloped financial sector and high political risk, all characterize the dynamic yet turbulent and high risk business environment which offers an exciting research ground for testing existing theories in international business [12].

Literature Review

Social Capital

Social capital has been defined as "the sum of resources, actual or virtual, that accrue to an individual or an organization as a result of the development of social networking relationship" which encompasses the "norms and networks facilitating collective actions for mutual benefits" [13]. The literature has evidenced that managerial actions are embedded in social networks of relationships, which includes purposefully establishing close relationships with supplier, customer, competitors, trade association and government institutionsand employing them to generate intangible and tangible benefits[3]. Through social capital, organizations may obtain access to high-quality information about product, market and technological advances that may influence firm performance positively in a micro-level that may be aggregated to macro-level phenomenon [9]. More importantly, social capital has been evidenced to exhibit greater significance in offsetting economic risks under higher levels of unpredictability in the firm's business environment by compensating for weak institution and regulations [14,9].

Dynamic capabilities

Dynamic capabilities are a set of specific and identifiable processes such as product development, strategic decision making, and alliancing whose strategic value lies in their ability to manipulate resources into value-creating strategies.Teece and colleagues [15] define dynamic capabilities as: the firm's processes that use resources—specifically the processes to integrate,

reconfigure, gain and release resources—to match and even create market change. Dynamic capabilities thus are the organizational and strategic routines by which firms achieve new resource configurations as markets emerge, collide, split, evolve, and die.The majority of the work on dynamic capabilities and the original work of Teece et al. [15] assert that dynamic capabilities were necessary to deal with rapidly changing environments. In turbulent environments, competitive advantage is thus dependent on dynamiccapabilities rather than simply competitive positioning or industry conflict.

Dynamic capabilities are best conceptualized as tools that manipulate resource configurations. Sometimes it is effective to use these tools to enhance existing resource configurations and to strengthen current position using RBV's path-dependent strategic logic of leverage. Here, the goal is long-term competitive advantage. It makes more sense to use dynamic capabilities to build new resource configurations and move into fresh competitive positions using a path-breaking strategic logic of change in dynamic markets[16]. Here, the goal is a series of temporary competitive advantages. The broad point is that a blend of strategic logics makes sense in dynamic markets.In moderately dynamic markets, dynamic capabilities resemble the traditional conception of routines and are detailed, analytic, stable processes with predictable outcomes. In contrast, in high-velocity markets, they are simple, highly experiential, unstable processes that rely on quickly created new knowledge and iterative execution to produce adaptive, but unpredictable outcomes.

Strategic Flexibility

Strategic flexibility implies effective sensing, organizational learning and strategic decision making process. From a strategy point of view, the success and performance of a firm depends on its strategic flexibility and the ability of a firm to adapt to the sudden changes in external environments [17]. Strategic flexibility is defined by Shimizu and Hitt[18] as an organization's ability to identify significant changes in external environments, quickly commit resources to new courses of action in response to those changes, and recognize and act promptly when it is time to halt or reverse existing resource commitments. When organizations face unfamiliar changes with far-reaching consequences, management needs to change its game plans, current strategies or, organizational structure. Porter [19] asserts that strategic fit and alignment of activities and capabilities are required to create a sustainable competitive advantage.

Transition economies are in a stage of transformation involving a shift from centrally planned economies to free-market economies; this implies rapid transition and escalating competition [12]. Transition economies are characterized by the presences of restructuring of administrative frameworks, redistribution of property rights, and shifting discretions over resource allocations. In addition, most of the emerging economies exhibit weak market supporting institutional infrastructure, and poor enforcement of property rights [20]. As such, transition economies offer tremendous opportunities to explore boundary conditions for strategic flexibility, fundamental premises of international business. Specifically, transition economies are "challenging testing ground" for firm performance concepts based on environment-resources-strategy linkages [4].

Economic Sanctions and Environmental Uncertainty

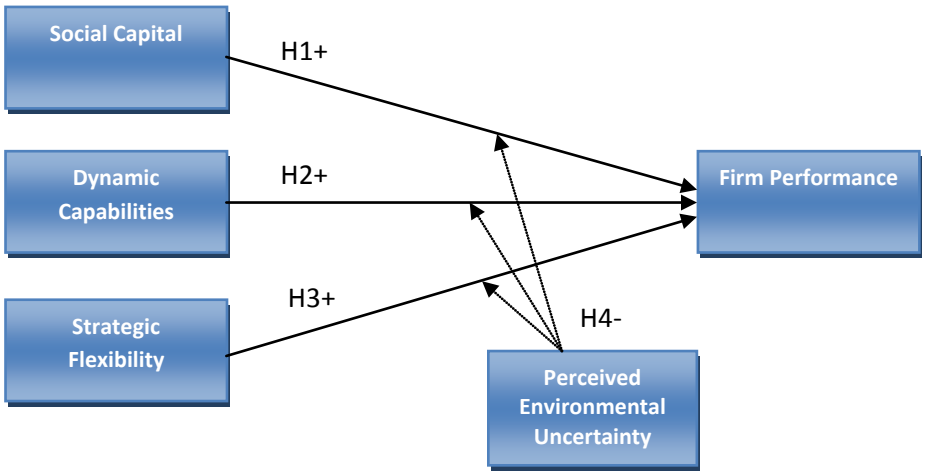
One of the major events that create environmental state uncertainty is the presence of economic sanctions. Economic sanctions have been used as an instrument of foreign policy for a

numbers of reasons and can be defined as actions with an intended goal to impose maximum economic harm in the target country and to damage the economic system of the receiving nation [21]. Economic sanctions are initiated by one or more international actors against one or more others with the purpose of punishing the receivers by depriving them of some value and/or to make the receivers comply with certain norms the senders deem important [22]. Economic sanctions are frequently a response to the urgencies of the moment in international affairs [23] and although economic sanctions are well intended, they create volatile, risky, unconventional and uncertain business environments where domestic business enterprises and people are mostly affected [22].

Research Model and Hypotheses

Theory development or empirical study on the impact of economic sanctions on firms in target countries from the perspective of international business and organizational theory is scarce. The manner in which firms in target countries manage to overcome such enormous challenges, along with the firm strategies, structures, resources and capabilities required for survival and growth, have been out of the scope of the IB literature. Similarly, theories developed in western economies have not been evidenced to be applicable in these countries.We argue that a firm's social capital, its dynamic capabilities and the strategic flexibility are three key answers for the survival and growth of firms in turbulent environments. Furthermore,we argue that a country under economic sanctions is anadvantageoustesting ground for IB researchers. Borrowing from the existing literature, we offer the following research model:

Figure 1.Proposed Research Model



In transition economies, social capital is one of the most important resources of a firm that is scarce, that cannot be cultivated in a short time, that cannot be duplicated, and that is more valuable on business exchange relationship than in developed economies because of the existence of "institutional voids" and the absence of market supporting institutions [20].Previous studies have evidenced direct and contingency effects of social capital on firm performance [3]. These studies argued that social capital can promote the creation of intellectual capital, develophuman capital, reduce the uncertainty in business environment, enable organizational to

be strategically more flexible, manage collective action, create competitive advantages, and produce better firm performance.

In Myanmar, the most important source of social capital originates from strong personal, social and business network relationships with high ranking government officials. Although Myanmar has implemented a free market economy, government officials have almost absolute power in approving projects, issuing permits and licenses, providing financial support in the form of low interest loans or different forms of project financing, and allocating resources in substantially subsidized prices. The chief military commander of each of all fourteen states has tremendous power in issuing executive decisions for all investments and business activities in their respective state. Similar social capital can be developed from strong relationships with ethnic group leaders of different origins. In Myanmar there are almost 153 ethnic groups and some of these groups have special privileges to conduct business activities that are not normally granted to ordinary business people. A firm with a close relationship with such ethnic groupswill generally perform better than its industry peers. The same level of social capital can be developed from the relationship with MNCs. Strong networking relationships with foreign firms in general, particularly with Chinese and Indian firms, are crucial source of social capital. Overall, firmswith close contact with any of the above mentioned groups have better access to benefits such as information and risk protection which have been posited to increase superior performance. Therefore we hypothesize that:

H1: Firms in transition economies that have developed social capital through network relationship with governmental, political, religious and ethnic leaders will tend to have better performance than firms without such social capital.

Teece et al. [15] explain that dynamic capabilities include four main processes: reconfiguration, leveraging, learning and creative integration. Empirical studies demonstrate dynamic capabilities increase profitability by (1) generating market intelligence by spotting, interpreting and pursuing opportunities in the environment, (2) acquiring, assimilating and exploiting knowledge by revamping existing operational capabilities with new knowledge, (3) interrelating diverse knowledgeinputs to the collective system of organizational groups by embedding newknowledge into the newoperational capabilities creating a collective sense-making, and (4) assigning appropriate resources and personnel to tasks and identifying synergies by orchestrating anddeploying tasks, resources,and activities in the newoperational capabilities[8]. Given the volatility of the institutions in emerging economies, we argue that dynamic capabilities are particularly needed to sustain high performance. Thus we hypothesize the following:

H2: Firms in transition economies with higher dynamic capabilities will have better performance than firms with lower dynamic capabilities.

For a firm to be strategically flexible, it requires dynamic management and flexible corporate governance. The firms should possess structural flexibility, operational flexibility and resources flexibility. At the same time firms need to “quickly commit resources to new courses of action in response to those changes, and recognize and act promptly when it is time to halt or reverse existing resource commitments” [18]. The competitive advantage of such firms is created by quick understanding of the situations and the ability to provide decisive responses without

delay at the time of emergency. For an organization to possess flexibility in resource allocations, firm resources should be as liquid and flexible as possible.

The strategic fit paradigm asserts that a flexible strategy to a specific environment can create a significant and positive business performance [4]. Hatch and Zweig [17] state that a key success factor of a strategically flexible firm is that it can keep tracking the opportunities and threats which may unexpectedlyappear given the dynamic environment; a business whose top management team has the ability to seize sudden opportunities and avert eminent threats will enjoy higher performance levels[24]. These decisions are normally made by the top management team (TMT); in Myanmar, such team is often the owners of the business. Thus, we hypothesize that:

H3:Firms in transition economies that have relatively high level of strategic flexibility will tend to perform better than similar firm with lower level of strategic flexibility.

Economic sanctions create an environment that is similar to an economic crisis. An economic crisis represents "a high impact situation that is perceived by critical stakeholders to threaten the viability of the organization" [25].In an environment of economic sanctions, a firm located in a targeted country will suffer disutilities. The initial and most common restrictions imposed by this policy include the restrictions on all export-import activities. When sanctions become more comprehensive and expand into other areas such as tourism, services and financial sectors, the impact is more severe and financial flows are distorted, the future becomes unpredictable and market risk increases. The significant impact of such crisis, which may be manifested in a firm's demise, makes it critical for managers to understand and effectively manage these events. In general, firms in target countries are exposed to serious business down turns because of economic sanction. Therefore, we propose the following hypothesis:

H4:Firm performance in a transition economy under economic sanctions is moderated by perceived environmental uncertainties associated with an economic sanction

Methodology

Sample and Data Collection

This research paper will consist of two phases. Phase 1 will aim to collect at least 100 electronic surveysfrom the principals of randomly selected companies' from both manufacturing and service sectors in Myanmar. The list of the firms will be prepared from trade directories published by the Ministry of Commerce and the Chamber of Commerce and Industry in 2011.The sample will include private enterprises, state-owned enterprises, foreign joint ventures and foreign MNCs, and these enterprises will be selected from different business areas and industrial sectors such as, government and private owned airlines, banks, hotels, oil and gas companies, transportation and logistics companies, private schools, trading firms, and private manufactures. Phase 2 will include supplemental face-to-face interviewswith participating CEOs. The survey methodology is selected as an appropriate method to conduct research in emerging economies where reliable secondary data is neither available nor able to capture the specific intangible variables of interest [3,4,9, 26], such as social capital, knowledge capital, and strategic flexibility.

Instrument

The study would use widely cited valid instruments from the existing literature. Given the English proficiency of all principals, the survey questionnaire will be designed in English. In order to overcome non-response bias due to the sensitive information of financial and social networks, the Federation of Chamber of Commerce andIndustry at Myanmar will be asked to endorse this project with a cover letter for the survey. This endorsement will assist in validating the academic value of this research with companies. A pretesting will be conducted to check the consistency and content validity, the appropriateness of the survey questionnaires, and to determine whether further improvements are necessary[4]. For that purpose, a sample set of questionnaires will be sent to owners and one executive director of 10 firms which has similar characteristics of the target sample and analyze the responses to compare the perceptions of the respondents on different measures in the questionnaires [27]. Appropriate informed consent will be obtained from participants in compliance with our institutional review board.

The independent variables are (1) social capital, and (2) strategic flexibility, and (3) dynamic capability.Social capital variables will be measured following the social capital construct adapted from Peng and Luo [9] and Acquaah[3], divided into five variables related to social capital developed from relationships with (1) government officials, (2) MNCs, (3) high ranking military officers, (4) ethnic group leaders, and (5) emerging domestic business groups. Each variable will be assessed in four measures: the hierarchy level of their social networks, the intimacy of the relationship, the access to market information and business opportunity, and the benefits for the firm. Dynamic capability measures will be measured with the four-dimension instrument developed by Pavlou and El Sawy[8] and strategic flexibility will be measured by five dimensions drawn from Lukas et al. [4]. All dimensions will be measured in seven items Likert scale.

Firm performance is used as our dependent variable and it will be measured in three subscales. In practice, it is not possible to get exact data from the sample firms as it is a natural phenomenon for them to keep the real data strictly confidential. In such situation, both objective and subjective information will be used for the study as suggested by [3]. The subjective information could be used in the study of social capital in emerging economies in situations when objective data are not available [28,29]. Customer performance, efficiency performance and financial performance have been found to be proper sub-dimensions of firm performance; consequently, we borrow from Luo et al. [5] to assess customer performance, Neill and Rose [6], and Park and Luo [7] to assess perceptual measures of performance as previously done in emerging economies.

The moderating effects of economic sanctions will be measured by proxies of perceived environmental uncertainty in four dimensions adapted from Lukas et al. [4]: (1) regulatory environment, (2) market environment, (3) political environment, and (4) international trade and investment. Each dimension will assess unpredictability, complexity, dynamism, and hostility/risk such as the frequency of changes in government policy regulating the industry. Our study will control for additional variables, such as firm size, firm ownership, business sectors and market competition.

Psychometric properties of measures

Psychometric properties of constructs will be evaluated by confirmatory factor analysis (CFA) using LISREL [30]. Following Podsakoff and Organ [31], Davies and Walters [32] suggest that during the development of the questionnaire, independent variables will be placed

before the dependent variables so that the impact of respondents' implicit effectiveness theories will be reduced. Aulakh et.al [29] suggests that the common method variance issue can be examined through post hoc statistical tests such as Hartman's [33] one-factor test. Exploratory factor analysis will be carried out as if common method variance is a serious issue in a data set, a single factor will emerge, or one general factor will account for most of the covariance in the independent and dependent variables [29]. Along with Cronbach's alpha analysis, Fornell and Larcker's[34] criterion approach will be followed to evaluate discriminant validity.

Statistical Analysis

The data analysis will be conducted using hierarchical moderated regression analysis to test the proposed hypotheses. The first model will test the relationship between control variables and performance. The second model will add social capital to first model. The third model will test include strategic flexibility anddynamic capability to the second model. The fourth model will test the moderating effect of environmental uncertainty. The fifth model will test the interaction effects between independent variables.

Conclusions

In this paper, we examine the relationship between social capital, dynamic capabilities and strategic flexibility in a transition economy under economic sanctions extending on resource–based and industry-based views, by including institutional view. We argue that social capital, dynamic capabilities and strategic flexibility and can help firms create competitive advantages for superior firm performance, and manage through drastic changes in external environments full of uncertainty and turbulence. We contend that strategic flexibility and dynamic capabilities mitigate the changes in external environment by allocating firm resources and eliminating lapse time for the implementation of strategies derived from business intelligence. Social capital developed from strong network relationships with external entities compensates for the short falls in market imperfections, and provides firms with opportunities and risk insurance in the midst of unpredictability, particularly in hermetic socioeconomic environments. We argue that such antecedents of firm performance are more necessary in volatile environments.

International and managerial implications

Theoretically, this study contributes to the literature of international business management by highlighting the importance of the highlighted factors for the survival and growth of firms competing in turbulent economies created by economic sanctions. Targeted countries are deprived of essential components of trade and investment while there is a drastic increase in market instability, unpredictability and overall risk. According to the Institute for International Economics, a significant portion of the world is under economic sanctions of different levels of intensity at any given time; as such, both transition economies and developed countries under economic sanctions provide exciting theory testing ground for international business researchers.Most previous studies on economic sanctions have been focused on the economic, political and public policy rationales and effectiveness of the imposing countries point of view. Research on how firms in target countries manage to survive and grow against such demise from the perspective of international business and organizational theories are almost non-existent.

While this study does not cover all the different countries under penalties, the practical implications from our theoretical model and its empirical examination should provide managers with concrete lessons for devising strategies in restrictive economies. The findings of this study may also be applied to other transition economies with high levels of uncertainty and rapidly changing firm environments in general and countries under economic sanction in particular.

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