Strategic Adaptation of Firms during Economic Liberalisation: Emerging Issues and a Research Agenda

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A large number of emerging economies around the globe have been charting a new path of development, popularly known as economic liberalisation, by adopting market based policies and administrative mechanisms. These rapid and widespread economy wide changes put pressures and pose challenges on firms, both domestic and foreign, public and private to adapt to the emerging situation. The paper establishes the uniqueness, importance, and, need for firm level managerial research in these country contexts. It identifies a set of critical strategic management issues faced by firms in the context of a liberalising economy. The paper also outlines a broad research agenda to test the power of existing theories developed through research in market oriented economies in explaining the strategic behaviour of firms during economic liberalisation and develop grounded theories in areas where anomaly exists.

Introduction

During the past two decades a number of countries around the world have undertaken economic reforms of varying magnitudes. In the business parlance these reforms are collectively known as economic liberalisation, which generally entails a large number of economy wide policy and administrative changes. Economic liberalisation has been initiated to bring in a significant shift in the regulatory framework of government, from a micro level command orientation towards macro level monitoring. These reforms are mainly aimed at ending the era of central planning through persistent measures towards deregulating the domestic markets, increasing their integration with global economy, reducing the role of government, and promoting market mechanisms to regulate the economy.

A number of studies are available on the impact of economic liberalisation in different country contexts (e.g., Agarwal, 1995; Choksi and Papagerogiou, 1986; Gupta, 1993; Hoon, 1998; Pomfret, 1996; Wadhva, 1994, etc.). However, the focus of these studies has mainly been at the aggregate level, viz., either the entire economy, sector or individual industries. Firms have received scant attention from researchers. Most of this research has been grounded in economic theories. The perspective taken is mainly of policy analysts, whereby issues relevant for managers have often been ignored. Whatever firm level research available in the form of case studies by the World Bank (e.g., Corbo and Melo, 1985) or by other researchers (e.g., Okoroafo, 1997) are incomplete and have many drawbacks (Muuka, 1997). These are not rooted to the management theories. Conceptualisation of strategy is also inadequate and many important strategic variables are left out. Moreover, neither the organisational variables such as structure, systems, resource endowments, leadership, and managerial processes are considered, nor the performance implications for differences in strategic behaviour are drawn.

This paper argues that the environmental contingencies faced by firms due to economic reforms are quite unique. Hence there is a need for several country specific, firm level studies on strategic adaptation of firms to environmental contingencies due to economic liberalisation. The growing importance of management research in these economies are evident from the fact that two special issues were dedicated by two leading management journals - *Academy of Management Journal* and *Academy of Management Review* in the year 2000. In this paper we have identified a set of critical strategic management issues faced by firms in the context of economic liberalisation. The paper also outlines a broad research agenda to study the strategic behaviour of firms during economic liberalisation.

Strategic Adaptation Research in Deregulated Industries and Economies

As a field of enquiry, strategic management is primarily concerned with the strategic adaptation of firms. Strategic adaptation is an outcome of this 'fit' achieved through the interplay of content of strategy, strategy making process, internal and external contexts of firms (Miller and Friesen, 1984). Strategy scholars have explored 'fit' between the environment and strategy and its performance implications adopting both reductionist and holistic approaches (Venkatraman and Prescott, 1990). Researchers, particularly those belonging to the configuration school, have included important organisational variables such as structure, leadership, and strategy making process along with strategy to study 'fit' with the environment (Dess, Newport, and Rasheed, 1993; Ketchen *et al.*, 1997).

Most of the studies on strategic adaptation of firms to environment have been conducted in the contexts of market driven economies where firms are traditionally free from governments' direct intervention and control. Market driven economies have never undergone economic reforms of such magnitude that are experienced by many Asian, European and Latin American countries in the recent years. With the legacy of a socialistic and planning oriented institutional framework, the recent economic transformations in these countries present a unique business environment for firms that is distinctly different from what a typical Western firm would encounter (Luo and Peng, 1999; Peng and Hearth, 1996).

People's Republic of China, which has been undergoing economic reforms since early eighties, has drawn considerable attention of researchers (e.g., Child and Lu, 1996; Keister, 1998; Luo and Peng, 1999; Luo, Tan and Shenkar, 1998; Peng, 1997; Tan and Litschert, 1994). Some firm level studies from a few other countries (e.g., Appiah-Adu, 1999; Okoroafo, 1997; Suhomlinova, 1999) have also been reported. These studies have looked into the contingency linkages of strategic behaviour with either environment or performance or both. However, an inductive approach has been adopted in most of these studies to develop theories from a few case studies. The notable exceptions are the studies conducted by Tan and Litschert (1994) and Appiah-Adu (1999) who have carried out large sample studies.

However, both these studies have some glaring limitations. Tan and Litschert (1994) have explored only the business unit strategies by focusing only electronics firms. Similarly, Appiah-Adu (1999) has chosen strategy variables relevant mainly for business level strategies. Moreover, the conceptualisation and operationalisation of environment and strategy by Appiah-Adu (1999) do not conform to the popular approaches adopted in contingency research. No organisational variables are included as antecedent to strategic behaviour of firms. This omission has posed limitations in identifying the predominant antecedent variables for strategic behaviour of firms - external or internal context, and show the extent of variation that is explained by each of these two categories of variables in the context of economic liberalisation.

Strategy scholars (e.g., Andrews, 1971, Porter, 1980, Utterback, 1996) have always recognised the role of government in regulating strategic behaviour of firms. Some of the scholars (e.g., Cook *et al.*, 1983, Mahon and Murray, 1980; Reger, Duhaime, and Stimpert, 1992; Smith and Grimm, 1987) have studied strategic adaptation to regulatory policy changes within single industry settings using contingency perspective. These studies have explored the strategic behaviour of firms during industry deregulation in the market driven economy and found distinct patterns, different from those in response to other environmental contingencies. Venugopal and Dixit (1999) provide a detailed account of these studies. The review of the extant literature clearly indicates that studies on corporate level strategic behaviour of firms are rare. The main reason is that most researchers often fail to appreciate the distinct environmental contingencies that firms face during economic liberalisation as compared to those during industry deregulation. As a result, they often choose to explore business level strategic behaviour of firms within an industry. In the process, they fail to capture the fundamental difference between strategic responses of firms to industry deregulation in a market driven economy and those to economic liberalisation in a regulated economy. This limitation is pervasive in most of the firm level studies in the emerging economies and makes these studies restrictive and inadequate.

Economic Liberalisation versus Industry Deregulation

The basic proposition of this paper is that studies in a single industry setting are not much of help and quite inadequate in predicting and explaining the strategic adaptation of firms to environmental changes subsequent to economic liberalisation in countries with long history of protection and control. We argue that the environmental contingencies during economic reforms are quite different than those during privatisation and deregulation of selected industries in a market driven economy. Like industry deregulation economic liberalisation consists of deregulation of a number of industries. However, economic liberalisation in contrast to industry deregulation is associated with a number of economy wide policy and administrative reforms, cutting across sectors such as trade, banking, and commerce, capital and labour markets.

Economic liberalisation has many facets. Many regulatory policies are done away with or modified to facilitate entry of private and foreign investors in a bunch of industries and ease the supply of resources such funds and technology from both domestic and international markets. Special thrusts are given to promote selected industries to boost exports and develop infrastructure. Along with the freedom from government control and greater autonomy to managers, policies are also initiated to expose domestic industries to intense competition from domestic and foreign firms. In the area of public sector, in exchange of more autonomy, governments stop budgetary support to public sector enterprises, divest some equity to private investors to bring in more accountability in their management, and also force them to augment their own financial resources.

Economic liberalisation gives easier and more economical access to foreign technology, raw materials, plant and machinery, etc., to domestic firms. Rationalisation of exchange rate and full convertibility of currency bring benefits by improving the cost competitiveness of domestic firms, thus providing better export opportunities. These also lead to increase in the capital cost of imported technology, plants, and equipment. In these economies, prior to economic liberalisation firms often faced various constraints to finance large projects. Often state owned financial institutions and banks were the only sources of funds at a high fixed rate of interest. However, in the liberalised era, several alternative sources of funds at varied terms are available to industry. The deregulation of interest rate structure allows banks and financial institutions to set the interest rate depending on their perception of risk. Terms of lending are varying depending on various factors such as reputation and performance of firms, composition of the business portfolio, and strategic plans for future. Moreover, capital market reforms have given firms the opportunity to use the stock market as an alternative source of funds. The domestic firms are also allowed to raise large amount of funds from the international capital markets at costs comparable to borrowing from banks and financial institutions.

As a part of the reform package the Government gives special emphasis to improve infrastructure by attracting direct foreign investment in road transport, telecommunication, aviation, port, energy, etc. It also takes up administrative reforms in government and quasi-government offices to improve efficiency. Tax structure and collection methods are simplified, and paper work related to custom, excise, tax, etc., are reduced. Processing of applications for new projects, capital issues, capital imports, etc., are expedited. Efforts are made to provide single window clearance facilities for foreign investors. All these are meant to improve the efficiency of the institutional framework prevailing in the country.

While some of these reforms provide better supply side environment to firms, deregulation, privatisation and globalisation measures also result into highly competitive domestic market. Reduction of tariffs results in lower protection to domestic firms from foreign imports. Unrestricted entry by foreign firms into most industries and permission to hold controlling stake in domestic firms create pressures on them to perform or perish. Moreover, domestic consumers, being exposed to foreign goods and services, become increasingly conscious of quality of products and services and exercise their rights by demanding more value for money. With greater money supply in the economy and encouragement to private entrepreneurship firms are also likely to experience a sharp change in demand for most industrial products.

During economic reforms firms operate in a more liberalised regime free from direct government intervention in strategic and operational decision making. Firms get greater autonomy in areas such as capacity and business expansions, export compulsions, compulsion to use indigenous technology and raw materials, decisions about the location of their production units, product pricing and product mix, technology imports and so on. As the entry barriers are removed in multiple industries at a time providing firms with opportunities to choose their domains of operations, the concern may not be just living up to the imminent threat of competition. There are other concerns such as which industry to enter; which business to retain or divest; how to leverage critical resources across businesses; which location; what technology - foreign or indigenous, to choose; what should be the mode of entry into new businesses - merger, acquisition, green field project, etc.; type of venture - fully controlled subsidiary, autonomous division, separate company, joint venture, etc., selecting the right sources of capital and other resources; what kind of organisation structure, systems, processes, etc., to be adopted; and so on. Even the dimensions of competition are likely to be different, as the entry barriers are removed not for the domestic firms alone but for the foreign firms, which may have far superior technology and other resources as well.

Along with the decision of how to compete it may become important to decide whether to compete or collaborate, if collaborate with whom, why, how, and how long. Even the substitutes may cause a serious concern for firms as with the opening up of economy better substitutes of some products from technologically advanced countries may make some existing businesses redundant. Thus translated to firms economic liberalisation means not only more competition from the domestic and foreign competitors; but also more autonomy to do business; more strategic options to choose from; higher opportunities for growth, profit, entry into new areas of business, exports, internationalisation, etc.; easier access to funds and other resources; improved infrastructures and institutional facilities; lower regulatory interference and hurdles, and so on.

This situation is quite unlikely for industry deregulation. The change in the environment due to industry deregulation is more relevant only to the single business firms and the business units of multi- business firms operating in that industry. While industry deregulation poses imminent threats of increased competition, it also provides greater autonomy for strategic and operating decisions to a firm. Firms in an industry subsequent to deregulation may have a greater range of options to choose from in relation to its expansion and competitive strategy. However, it is unlikely that just because of industry deregulation all firms will be provided with fresh opportunities to start new business, venture into new industries. In fact, researchers (Darroch, 1992; Mahon and Murray, 1980; Smith and Grim, 1987) observed that within industry firms face greater competitive pressure and shift to focus strategy from unfocussed strategy after deregulation.

Table 1: Comparative Scenario for Industry Deregulation and Economic Liberalisation

Dimensions	Industry Deregulation	Economic Liberalisation
Definition	It indicates the removal or slackening of government direct control over production capacity and entry of firms within an industry through the abolition of licensing, permit, etc.	It indicates the slackening of governmental control on micro management of economy through simultaneous changes in many aspects of economic and public policies and government administration in a country
Pace and span of change in business environment	Generally rapid, Restricted to an industry only - initiated through changes in regulatory policies. Changes are mainly in the demand side of firms' environment; factor market is normally not affected.	Generally not very rapid, made in steps. Economy wide changes initiated through changes in fiscal, monetary, industrial, trade, labour, public sector policies, administrative procedures, restructuring of bureaucracy, etc. Changes are expected in both the demand and supply sides of firms' environment.
To whom it matters	Relevant for mainly single-business firm or business unit of a multi-business firm, affecting primarily the business and functional strategies. All firms in the industry face the same pace of change.	Relevant for single and multi-business firms at both corporate and business unit level. Different sectors of economy go through varied degree and pace of change, resulting in differential impacts on firms from different industries.
Business opportunities and threats	Opportunity in the same industry for capacity expansion, improving scale of operation, higher growth, realisation of competitive advantage into higher profit, etc. Threat of competition from new entrants. Higher bargaining power of customers.	Opportunity in multiple industries for entry, capacity expansion, improving scale and scope of business, exports and internationalisation, higher growth, greater choice of technology, finance and other resources. Threats of competition from imports, entry of foreign and domestic firms. Higher bargaining power of customers.
Managerial concerns	Competitive and functional strategies: capacity expansion, technology upgradation, pricing and product mix decisions, creating entry barriers, becoming more market oriented, efficient operation, supply chain management, and customer focus.	Corporate, competitive and functional strategies: Choice of portfolio of businesses, corporate restructuring, capacity expansion, exports and internationalisation, technology selection and upgradation, mode of financing, mode of entry into new businesses, whether to compete or collaborate, with whom and how, what kind of collaboration, pricing and product mix decisions, creating entry barriers, becoming more market oriented, efficient operation, supply chain management, etc. Different concerns take priorities at different times. Balancing the need for opportunism and consolidation.
Concerns for policy makers	Fostering competition and providing autonomy to firms, allowing market forces to control the industry.	Rapid economic progress, reallocation of resources to priority areas providing autonomy, opportunities, better institutional and infrastructure supports, improving administrative efficiency, higher foreign investment, fostering competition, allowing market forces to control the entire economy, etc.

A summary of comparative scenario for industry deregulation and economic liberalisation on various dimensions is presented in Table 1. It is apparent that economic liberalisation brings up additional and a much broader range of issues for the strategic management of firms in comparison to industry deregulation. Moreover, industry deregulation is typically more rapid than economic liberalisation where different sectors of the economy experience varied degrees of deregulation, sequences and pace of change (Tan and Litschert, 1994). Hence, perceived change in the environment and subsequent responses by firms in an industry due to industry deregulation in a market driven economy is likely to be different from that by firms which operated in a controlled economy for long that is subjected to deregulation and liberalisation as a whole.

The above discussion is also a pointer to the fact that between economic liberalisation and a firm's strategic behaviour there is an intervening construct - the business environment of the firm. The effects of economic liberalisation would be visible in different attributes of firms' business environment. Firms for adapting to changing environment would act on the managerial perceptions about the changes in the environmental attributes (Child and Keiser, 1981). As the changes in different attributes of a firm's business environment during economic liberalisation are likely to be different, doubts could be raised about the extent to which theories developed based on studies in market driven economies are useful to predict and explain the strategic adaptation of firms during economic liberalisation in countries with long history of protection and control by governments.

Agenda for Strategy Research in Liberalising Economies

Economic transition in emerging economies offers a challenging and opportune research context for management scholars to test and refine existing theories and develop new ones. Some of the generic research issues and questions that could be addressed are as follows:

As the entry barriers are removed in multiple industries providing firms with opportunities to choose newer domains of operations, what would be the likely responses of firms? What would be the immediate managerial concern - to protect the turf from the imminent threat of competition by developing, acquiring and deploying critical resources or aggressive enter into other industries? How do they balance the conflicting demand of consolidating and improving the current businesses and exploiting the opportunities in the new areas? Which deregulated industries firms would target for entry? Would they enter into the deregulated industries blindly or would they enter only into those businesses, which are related to their existing businesses? What factors would determine the choice of industries? What factors would determine whether a firm would adopt an aggressive or defensive posture? What are the factors that would determine the success and failure of the firms in the emerging environment? What are the performance implications of different types of strategic responses?

What would be the strategies adopted in the existing businesses? What would be the strategies of firms to face the mounting competition and customers' expectation? What will be the basis of competition – price, differentiation, or customer service? Would they concentrate only on the domestic market or look outward for global expansion? What kind of firms would go global? What would be the approach towards internationalisation? How would the domestic firms bridge the gap in competitiveness existing between them and the global leaders in various industries? What are the resources and capabilities that would be critical in the emerging environment? Do firms possess them? How are they going to acquire, develop, and leverage those resources and capabilities?

Conclusion

The above list of questions is only an indicative one. The list can be much longer. The purpose of this paper is not to present an exhaustive list of research issues. We have attempted to indicate that there exists a vast potential for management research in the emerging economies with a hope that researchers would be stimulated to address these and many other questions. It also needs to be emphasised that cross-country studies on the subject are essential.

Cross-country studies are important as economic liberalisation of the emerging economies in Africa, Asia, and Latin America have some unique characteristics distinct from those in China and other East European countries (Lall, 1995). Unlike the socialist countries there has always been a dominant presence of privately held both indigenous and foreign firms, as private and foreign investments were allowed in selected industries. There are also mixed economies like India, not being fully centrally planned command economies, have always provided the privately owned firms with a high degree of strategic and operational autonomy, free from direct bureaucratic or political control widely prevalent in China (Child and Lu, 1996). However, in the liberalised era government regulation tends to become more uniform for all types of firms. Moreover, in some economies family held business groups dominate the business structure and system of the country (Khanna and Palepu, 1997). Hence some of the above mentioned issues could be studied for different units of analysis such as business groups, business and non business firms, and business units or divisions of individual firms.

Researchers have addressed some of these issues in isolation in different country contexts, such as China (Child and Lu, 1996; Keister, 1998; Luo and Peng, 1999; Luo, Tan and Shenkar, 1998; Peng, 1997; Senkow, 1995; Weidenbaum, 1996, etc.), India (Das, 1996; Manimala, 1996; Ray, 1998; etc.), Korea (Park, 1999, etc.), and Russia (Suhomlinova, 1999, etc.). However, these attempts are sporadic, unconnected, and inadequate. There is an acute need for more coherent, co-ordinated, and theoretically grounded studies on the above mentioned issues.

One stream of research should track a large number of firms to draw meaningful generalisation about the configuration of various organisational and environmental variables (Ketchen *et al.*, 1997). However, content-based, cross sectional studies are not adequate as economic liberalisation is a long-drawn process and evolves through several phases. With the progression of economic liberalisation firms face situations where opportunities dry up, sluggish demand and over-capacity plague the industries, resources become scarce and costly, competition and customer dissatisfaction mount, and pressure for consolidation intensifies. Hence studies should focus on both content and process of strategic adaptations and adopt both cross sectional as well as evolutionary approaches.

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