



# The impact of managerial networking intensity and market-based strategies on firm growth during institutional upheaval: A study of small and medium-sized enterprises in a transition economy

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**Abstract**

Varying institutional environments provide the foundation for a great deal of international business research, yet relatively little empirical work has examined the determinants of small and medium-sized enterprise (SME) growth during institutional upheaval, although the importance of SME development for economic transition and growth is widely acknowledged. Our paper addresses this gap in the literature by examining how the competitive strategies of SMEs evolve during institutional transitions, and assessing the implications for firm growth. Using data collected from 135 SMEs in 1993, and 200 SMEs in 2001, we find that managerial networking intensity (i.e., developing and maintaining relationships that may be used for business purposes) declines markedly over time, whereas the importance of market-based strategies increases. Managerial networking intensity is strongly associated with firm growth early in the institutional transition process, but not later. Market-based strategies are not associated with firm growth in either time period. Drawing on convergent insights from multiple theoretical perspectives, we argue that changes in strategy are concurrently driven by socially constructed norms that legitimize new ways of competing and delegitimize old ones, and by knowledge acquisition and learning, which provide managers with a more diverse set of tools with which to exercise their strategic choices.

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## INTRODUCTION

International business (IB) scholars have stressed how institutions create incentives and constraints on strategic choice, and suggest that successful firms must adapt their strategies to their institutional environments (Jackson & Deeg, 2008; Wan, 2005). Varying institutional environments thus provide the foundation for a great deal of IB research, as evidenced by recent special issues in the *Journal of International Business Studies* (Henisz & Swaminathan, 2008) and the *Journal of International Management* (Aulakh &

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Kotabe, 2008). Our study builds on and contributes to this growing body of work by examining institutional change and firm strategy in the context of transition economies. We aim to provide a better understanding of how the strategic orientations of small and medium-sized enterprises (SMEs) in transition economies may shift in response to institutional changes driven by market liberalization and the increasing presence of foreign competitors. More specifically, our study identifies factors associated with SME growth during the early and late phases of an institutional transition, and provides evidence of whether and how managerial networking activities and strategic choices evolve in response to institutional upheaval. We frame our arguments theoretically in the context of the institutional, social network and strategic management perspectives. A unique contribution of this study is to examine empirically whether and how determinants of SME growth change as broader institutional changes take place in transition economies. This study also adds to the entrepreneurship literature by providing insights into how the behaviors of entrepreneurs evolve in dynamic environments, and how such behavior might be linked to firm growth.

Transition economies comprise those post-communist (except China and Vietnam) countries in central and eastern Europe, east Asia and the newly independent states of the former Soviet Union that have rejected all or much of central planning in favor of a market orientation underpinned by widespread private ownership (Peng, 2003; World Bank, 1996). A major feature of the global economy over the past two decades has been the liberalization of these formerly protected markets and their integration into the worldwide economy (Aulakh & Kotabe, 2008). As a result of this there is a growing interest among IB scholars in understanding the competitive strategies of firms from these countries as they respond to institutional transitions and begin to compete internationally (Chittoor, Ray, Aulakh, & Sarkar, 2008). Transition economies thus provide valuable case studies and natural laboratories for IB scholars who wish to understand organizational transformation better in the context of institutional upheaval and global integration.

Transition economies have typically relied upon the growth of new SMEs to spur economic growth and employment, especially considering the difficulty of privatizing and restructuring large state-owned enterprises (Peng, 2000). Yet despite the

critical importance of SMEs to economic development, we know relatively little about what distinguishes more successful entrepreneurial ventures from less successful ones, particularly in the context of institutional upheaval. We use the term *institutional transition* (or the shorter term *transition*) to denote the process by which countries with centrally planned economies move toward a market orientation underpinned by widespread private ownership (Hoskisson, Eden, Lau, & Wright, 2000; Peng, 2000; World Bank, 1996). Institutions are typically conceptualized as the “rules of the game” in a society (North, 1990; Scott, 1995). Institutional transitions thus entail fundamental and comprehensive changes to the formal and informal rules of the game that affect organizations as players (Peng, 2003) and span the full range of a country’s political, legal, social and economic institutions.

Transition economies provide fertile settings for studying the strategies of entrepreneurial ventures over time because of their rapidly changing institutional and competitive environments. Policies aimed at encouraging competition in the domestic marketplace, urging local firms to build international levels of competitiveness, and allowing multinational enterprises to enter previously protected markets have brought about dramatic inflows of foreign direct investment (FDI), and have changed the competitive landscapes for firms from transition economies as well as for MNEs operating in them (Aulakh & Kotabe, 2008). As one of the most economically advanced of the transition economies in central and eastern Europe, Hungary has played a leading role in the region, and provides an insightful case study. Subsequent to its 1989 transition the country quickly attracted substantial inflows of FDI, built up a robust private sector and achieved solid economic growth with low unemployment. In its drive to join the European Union in 2005, it concentrated on completing its transformation agenda while establishing sustainable macroeconomic growth (World Bank, 2007). Considering this success, and the significant role that SMEs have played in Hungary’s economic transition, a better understanding of whether and how their strategies evolved as institutional transition progressed is a worthy endeavor (Lyles, Carter, & Baird, 1996). While individual countries follow different paths toward market reform, entrepreneurs in transition economies tend to face common challenges that stem from shared legacies of central planning, which may result in similar patterns of strategic responses

to institutional transitions (Danis & Shipilov, 2002; Peng, 2000). Hence the case of Hungary may help us to understand entrepreneurship development better in other transition economies, and may serve as a starting point for broader comparative analyses.

We utilize two points of time to test the impact of managerial networking intensity and market-based strategies on SME growth. Although a range of theoretical perspectives have been previously applied to transition economies by IB scholars (Meyer & Peng, 2005), our study is among the first to consider the relative explanatory power of the networking and strategy perspectives at different periods during the institutional transition process, and hence represents an important step forward. Following Peng (2003), we conceptualize institutional transition as a two-stage process comprising early and late phases. In spite of the fundamental changes that occurred in transition economies during the early 1990s, market-oriented institutions take years to develop (Child & Czeglédy, 1996; North, 1990). In consideration of this, existing institutions in the early phase of transition will be immature, and inconsistent with the needs of a market-driven system. Prior research reveals that networking is more intense in environments where institutions are weak or absent, or where trust in institutions is low (Batjargal, 2003; Peng & Luo, 2000), and that networking plays an instrumental role in facilitating business activity in such challenging contexts (Peng, 2003; Peng & Heath, 1996). Until new rules of the game are firmly in place, the early transition environment will be fraught with transaction costs, and managers will thus rely on informal, personal contacts to achieve organizational goals (North, 1990; Peng, 2003).

In the later phase of an institutional transition new rules of the game become more firmly established as institutions strengthen and mature. More firmly established institutions make market-based, arm's length exchange relationships increasingly viable owing to lowered transaction costs, whereas returns on intensive personal networking may diminish (North, 1990; Peng, 2003; Williamson, 1994). At this point managers may be compelled to spend less time networking and focus more on developing market-based strategies in pursuit of their organizational goals (Peng, 2003).

In light of the above discussion, our study considers the following questions:

- (1) Does managerial networking intensity decrease as institutional transition progresses?
- (2) Does the perceived importance of a market-based strategy increase as institutional transition progresses?
- (3) Is managerial networking intensity more strongly associated with firm growth than a market-based strategy early in the institutional transition process?
- (4) Is a market-based strategy more strongly associated with firm growth than managerial networking intensity later in the institutional transition process?

### THEORETICAL PERSPECTIVES

Our fundamental premise is that as institutional transition evolves so will the determinants of firm performance. The early years of transition are typically characterized by economic decline, social upheaval and political uncertainty, resulting in a highly uncertain environment, and SMEs are disproportionately affected by this turbulence (Meyer & Peng, 2005; World Bank, 1996). However, as transition progresses, the competitive landscape typically stabilizes as continuing economic and institutional reforms take hold (Warner & Cornelius, 2002). Because of this dynamic context, it is unlikely that a single theoretical approach is capable of explaining strategic decisions in the high-velocity environments that characterize transition economies (Wright, Filatotchev, Hoskisson, & Peng, 2005). We therefore apply convergent insights from three complementary theoretical perspectives – institutional theory, networks and strategic management – to achieve a more nuanced view of the dynamic links between strategic choice and firm performance during institutional upheaval.

#### Institutional Theory in the Context of Transition

The economic perspective on institutional theory, as represented by North (1990), focuses on the role that political, social and economic systems play in shaping social and organizational behavior. Institutional forces affect managerial behavior and firm strategy because they provide constraints and establish rules of the game by which enterprise managers must operate and also serve to legitimize certain forms of managerial and enterprise behavior relative to others (DiMaggio & Powell, 1983; North, 1990). IB scholars have thus emphasized how institutions influence incentives and constraints on strategic choice (e.g., Wan, 2005). Much of the institutional theory literature has focused on

institutional isomorphism, a process by which organizations coalesce around common routines and practices that become legitimized as a consequence of their conformity to the norms and expectations of the institutional environment (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Scott, 2001; Zucker, 1987). However, large-scale discontinuous institutional transitions, such as those that have occurred in transition economies, can cause prevailing organizational practices to become obsolete as shared normative understanding and institutional acceptance of established organizational actions begin to weaken via the process of deinstitutionalization (Greenwood & Hinings, 1996; Oliver, 1992). As the changes associated with transition (e.g., social upheaval, technological disruption, competitive discontinuities, regulatory and political changes) precipitate, the institutional landscape is transformed as new ideas and organizational practices appear, diffuse, become objectified and gain legitimacy through a process of reinstitutionalization (Greenwood, Suddaby, & Hinings, 2002; Suchman, 1995). As part of this process, organizations may shift their strategic orientations in order to conform to the newly emerging institutional environment and survive. In the context of our research questions, the deinstitutionalization and reinstitutionalization perspectives would suggest a strategic shift from managerial networking toward market-based strategies. In the sections that follow, we elaborate on this proposition by supporting it with convergent arguments from the networking and strategic management perspectives, which we apply to the setting of transition economies.

### The Value of Social Networks during Transition

The discovery of new business opportunities and the mobilization of resources needed to pursue those opportunities are two key aspects of the entrepreneurial process that may be better understood via a social network approach (Stuart & Sorenson, 2005). Recognizing and exploiting entrepreneurial opportunities requires individuals to bring together previously disparate ideas and knowledge in such a way as to exploit the complementarities between them (Schumpeter, 1934). Social networks shape the entrepreneurial process, because recognizing opportunities of this nature typically requires private information about potentially complementary domains, and social networks provide the conduits through which such private information flows (Stuart & Sorenson, 2005).

Resource mobilization, which is a particularly critical aspect of the entrepreneurial process in transition economies, is also facilitated by social networks. Well-networked entrepreneurs are better able to access financial and human capital, and networks also act as conduits through which social influence operates during the resource mobilization process (Friedkin, 1998; Stuart & Sorenson, 2005).

Network relationships can also have a reputational or signaling content such that positive perceptions based on a firm's network linkages may lead to beneficial information and resource exchanges (Stuart, Hoang, & Hybels, 1999). Finally, research suggests that well-networked entrepreneurial firms may enjoy higher growth rates (Stearns, 1996; Zhao & Aram, 1995) and better performance (Baum, Calabrese, & Silverman, 2000). In sum, the networks perspective provides an enhanced understanding of entrepreneurial processes and outcomes, particularly with regard to opportunity recognition, resource mobilization, growth and performance. Building on these insights from the entrepreneurship literature we now explore how and why networking facilitates business activity in transition economies, thereby achieving a more nuanced understanding of social networks in this context.

Social networks serve as a means of facilitating business activity in transition economies, and have been widely recognized in the literature as affecting firms' strategic choices and performance (Batjargal, 2003; Batjargal & Liu, 2004; Chung-Leung, Yau, Sin, Tse, Chow, & Lee, 2008; Peng & Luo, 2000; Xin & Pearce, 1996). During institutional upheaval social networks play a vital role in facilitating economic exchange, and managers are likely to devote substantial time to developing and maintaining them. In this setting, network ties can provide rich and trusted sources of timely information that compensate for institutional voids and allow managers to make better sense of their complex and dynamic competitive environment. Such ties may also facilitate access to resources that may be critical for survival and growth (Peng & Luo, 2000; Xin & Pearce, 1996).

Our specific focus in this study is on *managerial networking intensity*, which we define as the extent to which managers invest their time in developing and maintaining relationships that may be used for business purposes. Networking intensity is an established construct in the psychology and organizational behavior literatures, where it has been examined in the context of seeking employment



(cf. Forret & Dougherty, 2004; Wanberg, Banas, & Kanfer, 2000). In the context of our study, it captures the extent to which managers focus their efforts on building and maintaining contacts that may be instrumental for obtaining business information, leads, advice or other potentially useful resources. In light of the uncertain economic, social and institutional environments that characterize transition economies, the network perspective suggests that managerial networking intensity will be a critically important determinant of firm performance *early* in the institutional transition process (Peng, 2000, 2003).

### Strategic Management and Market-Based Strategies

The competitive strategy perspective argues that a firm enjoys superior performance when it is able to develop unique organizational resources, capabilities and competencies (Barney, 1991) and align these with environmental opportunities and threats (Bourgeois, 1980; Child, 1972; Schendel & Hofer, 1979). In this view, sustained competitive advantage will result when managers are able to craft coherent competitive strategies and implement them effectively. While much of the strategic management literature has stressed patterned activities oriented to relatively specific objectives, such as low-cost vs differentiation strategies (Porter, 1980), the dynamic capabilities perspective in particular has recognized that achieving strategic alignment is a dynamic process by which managers alter their resource configurations to achieve strategic fit with an often-changing environment (Eisenhardt & Martin, 2000; Teece, Pisano, & Shuen, 1997). This idea is especially germane in transition economies, which face high-velocity environments characterized by rapid political, economic and institutional change accompanied by relatively underdeveloped factor and product markets (Wright et al., 2005). In this context, dynamic capabilities might entail the development of new technologies, products or services, or the adoption of a managerial orientation that allows for responsiveness and strategic flexibility (Uhlenbruck, Meyer, & Hitt, 2003). In sum, the strategic management frameworks focus largely on market-based competitive methods or capabilities as central to explaining firm performance. Although a firm's competitive strategy might encompass both networking and market-based competitive methods, we are interested in distinguishing between these two facets of strategic behavior and assessing their

separate impact on firm growth at two points in time. Therefore we henceforth use the term *market-based strategies* to refer to competitive methods that are focused on product/market domains, technologies, operational routines and managerial orientations related to the design, production and delivery of the firms' products and services. We use the term *managerial networking intensity* to refer to strategic behavior that is explicitly focused on developing and maintaining relationships that may be used for business purposes.

### Hypothesis Development

North suggests that the process of institutional change is incremental, because it comprises "marginal adjustments to the complex of rules, norms and enforcement that constitute the institutional framework" (1990: 83). Other scholars point out that although institutions evolve through periods of equilibrium, during which incremental changes occur, these evolutionary periods are punctuated by discontinuous transformations (Gersick, 1991; Peng, 2003; Tushman & Romanelli, 1985). This pattern is essentially what occurred in Hungary during the 1990s. After a period of incremental reforms implemented by the communists during the 1980s, sweeping new reforms were launched during 1990 aimed at fundamentally transforming the political, economic and institutional landscape. Although the reforms occurred virtually overnight, the political and legal decisions that precipitated these radical changes focused on formal rules. Yet informal constraints, which play a fundamental role in regulating economic exchange, are more impervious to deliberate policies, and may change more incrementally (North, 1990; Peng & Heath, 1996). Institutional transitions thus constitute a crossroads whereby the deep structure (Gersick, 1991) of old institutions gradually gives way to new ones (Peng, 2003). By temporally bracketing the transition in two phases (Peng, 2003) we are better able to examine how institutions and strategic choice co-evolve over time (Zaheer, Albert, & Zaheer, 1999).

**Early-phase transition.** We argue that, in the early years of an institutional transition, the importance and effectiveness of market-based strategies will be low. This is partly because coherent strategies are difficult to formulate and implement in environments characterized by upheaval and discontinuous change, where market institutions have not yet matured. In such environments managers adopt

a survival mentality, where strategy is more akin to improvisation than to planning and implementation (Danis, 2003; Danis & Parkhe, 2002). Moreover, as a consequence of the politically administered resource allocation mechanisms that typify centrally planned economies, transition economies inherited institutional environments characterized by excessive regulation and bureaucracy (Danis, 2003). In such environments, obtaining influence with politically powerful individuals is likely to be a key managerial focus, as this ensures access to resources (Holt, Ralston, & Terpstra, 1994). Similarly, in the *nomenklatura* system that existed in communist countries prior to transition, becoming a manager, developing a career and doing managerial work meant making the right contacts with the right people (Soulsby & Clark, 1996). The importance of networking in socialist economies is well documented (cf. Kornai, 1992; Sampson, 1986) but it assumes special significance during transition (Hankiss, 1990; Rona-Tas, 1994). In a newly developing market economy information about prices, demand or the availability of goods is still difficult to obtain, and much of this information is carried through horizontal channels of personal connections during the early phase of an institutional transition. Vertical ties are equally important. Institutional change generates high uncertainty, because new rules and the details and consequences of their implementation are difficult to understand and anticipate (Bunce & Csanády, 1993). Having connections to individuals in the political bureaucracy can provide early knowledge of new laws and regulations and the unwritten rules of their interpretation (Rona-Tas, 1994).

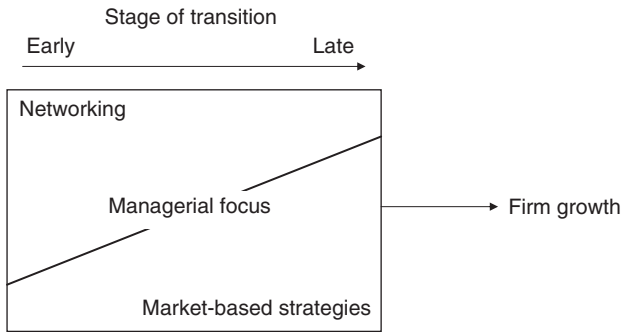
Entrepreneurial firms, in particular, face unique institutional pressures early in institutional transitions. Regulative pressures for them to engage in market-based exchange may be weak, owing to institutional voids; however, they need to rapidly build ties with larger and more powerful players in order to establish legitimacy, thus necessitating a networking strategy (Peng, 2003). Hence we argue that:

- (1) managerial networking intensity will be higher early in a transition, and
- (2) that it will be a stronger predictor of firm performance early in a transition than will market-based strategies (i.e., strategies focused on the design, production and delivery of a firm's products or services).

**Late-phase transition.** Later, we expect the pattern described above to reverse. As a transition progresses, pressures to pursue market-based strategies are likely to intensify while pressures to pursue networking strategies should decrease. As economic reforms and new institutions take shape, the competitive environment stabilizes. In this context, it becomes easier for a manager to accurately assess their firm's situation and develop appropriate strategies. Market-based strategies, which are predicated largely on the existence of effective institutions that facilitate exchange between otherwise weakly connected market participants, become more viable as sufficient institutional infrastructure develops to support them (Bruton, Fried, & Manigart, 2005). Furthermore, more firmly established rules of the game during the latter stage of a transition make market-based exchange relationships increasingly viable, owing to lowered transaction costs, whereas returns on intensive networking may diminish (Knack & Keefer, 1997; North, 1990; Peng, 2003). As market-supporting institutions and reforms are gradually adopted, the competitive environment intensifies as large numbers of foreign entrants and new domestic start-ups enter the market. During this time, a new norm centered on market competition is likely to emerge as entrepreneurs must prove themselves as legitimate players with high-quality products and services (Peng, 2003). In this increasingly competitive environment relationships alone may no longer be sufficient (Peng, 2003), and unsatisfactory performance may induce managers to search for new competitive advantages (Filatotchev, Buck, & Zhukov, 2000).

In addition to competitive pressures, normative pressures for adopting market-based strategies should also increase. Exposure to alternative modes of competing via the growing presence of foreign companies and expatriates and the proliferation of Western-style training and MBA programs (Hull, 2000; Pleskovic, Aslund, Bader, & Campbell, 2000), as well as by new domestic competitors, may compel managers to imitate their new rivals. With the spread and legitimation of market-based strategies introduced by these new competitors, managers are more likely to view them as important facets of their competitive strategy. Hence we argue that:

- (1) the perceived importance of market-based strategies will be highest later in an institutional transition; and



**Figure 1** The relationship between managerial focus, stage of transition and firm growth.

- (2) market-based strategies will more strongly predict firm performance later in an institutional transition than will managerial networking intensity.

In sum, we expect managerial networking intensity to be higher early in a transition rather than later, and we expect the importance of market-based strategies (as an element of the firm's overall competitive strategy) to be higher later in a transition rather than earlier. Likewise, we expect managerial networking intensity to be the most important determinant of firm growth early in a transition, and market-based strategies to be most important later in a transition. Figure 1 provides a graphical depiction of the model just outlined. Hypotheses derived from the above discussion are as follows.

**Hypothesis 1:** For SMEs in transition economies, managerial networking intensity will decrease as an institutional transition progresses.

**Hypothesis 2:** For SMEs in transition economies, the importance of market-based strategies will increase as an institutional transition progresses.

**Hypothesis 3:** For SMEs in transition economies, managerial networking intensity will be more strongly associated with firm growth than market-based strategies during the early phase of an institutional transition.

**Hypothesis 4:** For SMEs in transition economies, market-based strategies will be more strongly associated with firm growth than managerial networking intensity during the late phase of an institutional transition.

## METHODS

### Background and Research Setting

With the election of a democratic government in Hungary during 1990, sweeping new reforms were launched, geared toward establishing a predominantly private market economy integrated with Western Europe (Burant, 1990). When the initial data for this study were collected in 1993, reforms were under way, with the domestic private sector accounting for over 35% of Hungary's official gross domestic product (GDP). Unofficial estimates, which included Hungary's hidden economy (defined as unreported economic activities that are socially useful), were over 40% (Ernst, Alexeev, & Marer, 1996). Despite this progress, Hungary's macroeconomic environment continued to suffer dislocations resulting from the combined effect of rapid reform and the legacies of central planning. Following a sharp drop in GDP in 1991, Hungary's economy continued to shrink in 1992 and 1993, amounting to a cumulative drop in GDP of 18%, before a modest turnaround began in 1994. Annual inflation in 1993 was high at 22%, and the unemployment rate was 13%. In addition to, and partly because of, a difficult macroeconomic environment, SMEs were faced with the difficulty of acquiring financing, exacerbated by the underdevelopment of the banking system and capital markets. Political uncertainty during the time leading up to Hungary's 1994 national elections also contributed to a highly uncertain competitive environment (Ernst et al., 1996). Following the election, a new government led by Gyula Horn implemented far-reaching structural reforms complemented by a strong fiscal stabilization package. This, combined with sound macroeconomic policies, led to a period of sustained economic growth (World Bank, 2007). By the time the next round of data was collected in 2001 Hungary was widely regarded as among the most advanced transition economies, and was enjoying sustained economic growth.

Table 1 provides a comparison of institutional quality early in the Hungarian transition (1990–1996) with institutional quality later in the transition (1997–2002). For example, the World Bank's index of regulatory quality indicates that Hungary's regulatory regime was much more consistent with a market-driven system in the later phase of the transition than it was in the earlier years. The index of economic liberalization (de Melo, Denizer, & Gelb, 1996) provides further evidence of Hungary's

**Table 1** A comparison of institutions and factors in Hungary for various years<sup>a</sup>

Variable	Source and measure	Transition phase <sup>b</sup>	
		Early	Late
<i>Institution</i>			
Regulatory quality	World Bank Governance Indicators for 1996 and 2002; 0–2.5, “low quality” to “high quality”	0.47	1.21
Liberalization index	de Melo et al. (1996) for 1990 and 1997; authors’ update for 1997; 0–1, limited to high liberalization	0.57	0.93
Corruption index	Transparency International for 1990 and 2000; 0–10 “high corruption” to “low corruption”	1.60	5.20
Government stability	International Country Risk Guide for 1991 and 2002; 0–12, “unstable” to “stable”	6.00	10.00
Government transparency ranking	World Competitiveness Report, IMD, for 1994 and 1999	43.00	13.00
Private sector percentage of GDP	World Development Indicators, World Bank, 1991 and 2000	30.00	85.00
<i>Factor markets</i>			
Consumer price index	World Development Indicators, World Bank, for 1991 and 2000	35.00	9.80
GDP per capita (US\$)	International Country Risk Guide, for 1991 and 2002	3221.00	5462.00
Real GDP growth	International Country Risk Guide, for 1991 and 2002	–11.90	3.80
Number of registered firms	Central Statistical Office, Hungary, 1991 and 2001	8948.00	154,153.00
Growth in R&D (%)	OECD reports for 1993 and 1999	–8.50	3.50
Total number of patent applications	Hungarian Patent Office for 1992 and 2000	9070.00	62,562.00
Quality of management ranking (productivity, efficiency, market culture)	World Competitiveness Report for 1995 and 2000	46.00	27.00
Entrepreneurship ranking	A lower number indicates better quality	45.00	18.00

<sup>a</sup>Adopted from Steensma et al. (2005).

<sup>b</sup>A consistent set of years could not be used as different data sources had different reporting periods.

commitment to free its markets from government control during the 1990s (a rating of 0.57 in 1990, and of 0.93 in 1997; 0–1 scale). Corruption is a primary source of contractual uncertainty (Stiglitz, 1995). Transparency International’s index of corruption, the level of dishonesty, bribery and fraud in Hungary, has waned significantly owing to the advent of a more stringent legal regime (a rating of 1.6 in 1990, and of 5.2 in 2000; 0–10 scale). According to the World Competitiveness Report (IMD International and World Economic Forum, 1991), the transparency of the Hungarian government’s actions also improved greatly, thereby reducing marketplace uncertainty. The fact that the private sector’s contribution to GDP increased nearly threefold from the beginning of the 1990s to 2000 indicates that more market-friendly institutions had evolved.

Table 1 also provides a glimpse of the progress that Hungary has made in its factor markets from the early to the late transition phase. The growth rate of GDP, a common indicator of the development of economic factors in transition economies,

went from negative territory in 1991 to a respectable 3.8% by 2002. The number of registered incorporated firms likewise grew from just under 9000 in 1991 to over 150,000 in 2001. The development of human factors plays a particularly important role in an economy’s transition by increasing the capacity and motivation of local firms to learn (Newman, 2000; Uhlenbruck et al., 2003; Whitley & Czaban, 1998). There is ample evidence of improvements in this regard (see Table 1). For example, aggregated R&D is viewed as a key component of a national capacity for learning (Dahlman & Nelson, 1995). Growth in R&D went from negative in 1993 to positive during the latter half of the decade. The total number of patent applications increased sixfold, indicating a greater experience base to build on for learning. An entrepreneurial ideology that encourages innovation facilitates learning under times of intense change (Meyer, 1982). The World Competitiveness Report (IMD International and World Economic Forum, 1991) ranked Hungary 45th in 1995, and labeled its lack of entrepreneurship as a significant



liability. By 2000, however, Hungary was ranked 18th in the World Competitiveness Report, and entrepreneurship was considered one of Hungary's strengths. The quality of local managers also improved, going from a ranking of 46 to a ranking of 27 between the years 1995 and 2000.

In sum, weak institutions and undeveloped factor markets characterize the early phase of Hungary's economic transition (the early 1990s), whereas market-driven institutions and relatively robust factor markets characterize the late phase (the early 2000s). Hence the Hungarian transition appears to be highly consistent with the two-phase model elaborated by Peng (2003) and that of many other transition economies.

### Sample

The study employed stratified sampling to ensure that the industry distribution in our 1993 and 2001 samples was consistent with that of the total population of Hungarian SMEs for these two time periods. Stratified sampling improves sampling efficiency by explicitly taking subsamples of fixed size within different sections (in our case, industries) of a population (Simon, 1978). Population level data were provided by Hungary's Central Statistical Office (Kopint Datorg). The firms that participated were identified in several ways:

- (1) through their membership of the Hungarian Association for Entrepreneurs;
- (2) through the client list of a non-profit consulting firm assisting nascent entrepreneurs and small businesses;
- (3) through participation in trade shows;
- (4) from yellow page listings; and
- (5) from government listings of SMEs.

We included in our analysis only those firms that were over 1-year old, to ensure that they could provide sufficient performance data. Firm size ranged from 11 to 350 employees.<sup>1</sup> Of the 540 Hungarian SMEs that we identified and asked to participate in our 1993 study, 135 agreed. The sample for 2001 included 200 SMEs. To maintain independence between the 1993 and 2001 samples we used non-overlapping firms: this provided us with one sample for early and one for late transition respectively (117 firms for 1993 and 182 for 2001). We also used the firms for which we had data across the two time periods (19 firms) to test some of our direct hypotheses. The response rates for both time periods were approximately 25%, which compares favorably with most

survey-based international research (Dawson & Dickinson, 1988).

For each firm, data were collected from a structured interview with the founder/manager or president, most of whom had been involved with the enterprise from its inception. Personal interviews were used in order to provide richer and more reliable data, and because mail or telephone surveys were expected to yield a much lower response rate. Ideally, multiple informants would have been used, but this was not possible owing to limited resources. Prior research indicates, however, that one can rely on the general manager for data about venture management and performance, particularly for small, specialized or non-diversified firms (Birley & Westhead, 1990; Nayyar, 1992; Powell, 1992; Stearns, Carter, Reynolds, & Williams, 1995; Zahra & Covin, 1993), as was the case for the SMEs we studied. A standardized interview protocol was developed, translated and back-translated via an iterative process until equivalence of meaning was achieved (Brislin, 1970; Douglas & Craig, 2007), and administered by carefully selected and trained Hungarian interviewers in order to minimize interviewer bias. To reduce the possibility of common method bias (Harrison, McLaughlin, & Coalter, 1996; Podsakoff, MacKenzie, Lee, & Podsakoff, 2003), given that all our data was obtained from the general manager, (1) the instruments used to measure our constructs had multiple items, and (2) they were presented in clearly separated sections in the survey and the corresponding interview. All interviewers were fluent in English and Hungarian, although virtually all interviews were conducted in Hungarian. The interview process yielded firm data on competitive practices, management characteristics and performance, as well as other pertinent information, during 1993 and 2001.

### Measures

**Managerial networking intensity.** As noted previously, we conceive of managerial networking intensity as a function of time spent developing and maintaining business-related contacts. Consequently, we used formative composite indicators for capturing two distinct aspects of this construct: (1) the extent to which managers developed new contacts (meeting new people) with whom they discussed business matters; and (2) the extent to which they maintained contacts (talking to individuals they already knew) about business matters. Our respondents estimated the total number of hours

spent in a typical week in such activities, and we summed these estimates into a composite measure of overall networking intensity. Our use of formative indicators was based on a careful evaluation of established criteria for distinguishing between reflective and formative measures (Jarvis, MacKenzie, & Podsakoff, 2003; MacKenzie, Podsakoff, & Jarvis, 2005), and is consistent with prior work measuring managerial networking in transition economies (Lyles, Saxton, & Watson, 2004). The measure captures well the variability of managers' networking intensity across various contexts. Specifically, as demonstrated in prior research (Lyles et al., 2004), this measure of networking has no significant correlations with firm age, type of strategy used, industry turbulence, initial capital or other key variables.

**Market-based strategies.** For our second predictor, *market-based strategies*, interviewees were asked to indicate on a four-point scale (ranging from insignificant to critical) the extent to which five competitive strategy attributes were important to their firms in the last 2 years:

- (1) effective marketing/advertising;
- (2) fast response to changes in markets;
- (3) more contemporary, attractive products;
- (4) the development and use of new/advanced process/manufacturing technology; and
- (5) the development of new/advanced product technology.

The interviewers prefaced this question with the following explanation:

"It is rather common for firms to choose different methods through which to compete. The methods chosen usually reflect particular strengths of the firm, specific demands of the strategy and the nature of the environment. Listed below are several factors that might be used as methods of competing. Rarely if ever would any firm place a major emphasis on all of these. Rather, most firms selectively emphasize particular ones that best operationalize a chosen strategy. Please indicate the degree to which your firm emphasized each competitive method over the past 2 years." Consistent with the dynamic capabilities perspective outlined earlier, the five items measure the ability to quickly respond to changing market conditions as reflected by novel, innovative and dynamic competitive methods related to technology, products and services, and marketing/advertising techniques.

**Firm growth.** Considering the importance of SME growth to economic development, and the problems in obtaining accurate profitability data in transition economies, we conceptualized performance as a function of revenue and employee growth. Our dependent variable, *firm growth*, comprised the percentage growth in sales and the percentage growth in the number of employees during the prior 2 years. A formative composite growth measure was calculated by averaging these responses.

### Moderator and Control Variables

We use transition phase (early vs late) as a moderator variable, because each phase represents a relevant and empirically distinct time period with respect to Hungary's institutional development (Table 1). Time period (1993 vs 2001) is therefore used as a proxy for capturing changes in Hungary's institutional environment from 1993 to 2001. This approach follows recommendations by scholars who have called for a more explicit specification of time scales in the research process (Zaheer et al., 1999). It is consistent with Peng's (2003: 283) conceptualization of institutional transition because it constitutes a "temporal bracketing" approach that provides time-based benchmarks for assessing institutional and organizational transformation longitudinally. This allowed us to empirically model the major changes in Hungary's institutional environment during a well-defined time period. We controlled for firm size (number of employees), number of previous organizations the general manager has worked for, firm age (in years), and whether a firm was engaged in manufacturing or services.

### Data Analyses

We first checked the psychometric properties of the market-based strategy measure (i.e., unidimensionality, estimated reliability). Further, for our first two hypotheses, we used *t*-tests to assess whether the reliance on managerial networking and market-based strategies changed over time, using both the common and the non-overlapping firms across the two time periods (early and late transition). Next, we explored Hypotheses 3 and 4 using hierarchical regression analysis (Steensma, Tihanyi, Lyles, & Dhanaraj, 2005). Based on guidelines for detecting moderators in strategy research (Yip & Tsang, 2007), we created dichotomous variables capturing the early (1993) and late (2001) transition. We then standardized our predictor and criterion variables for easier interpretation, and tested the interaction.

To address potential multicollinearity concerns we also assessed the correlation between our independent measures (which was less than 0.10), and confirmed that the tolerance values for our data were well within accepted ranges (Hair, Anderson, Tatham, & Black, 1998).

## RESULTS

### Factor Analysis

We provide information on the dimensionality and estimated reliability of our market-based strategy scales in the Appendix. A factor analysis based on principal axis extraction and varimax rotation confirmed that the scales are unidimensional and the items form one coherent scale. Estimated reliabilities were 0.75 and 0.65 for the 1993 and 2001 datasets respectively, and the median loading across time periods was 0.64.

### Descriptive Statistics and Correlations

Means, standard deviations and correlations for the variables in the study are provided in Tables 2 (early transition, 1993) and 3 (late transition, 2001). An inspection of the tables reveals that the data are consistent with our proposed relationships. Managerial networking intensity is higher in the early

years of the transition, and the opposite is true for market-based strategies, which are emphasized more in the late transition years. Correlation patterns show that managerial networking intensity and market-based strategies are differentially related to firm growth. For example, networking intensity is related to growth in early ( $r=0.26$ ,  $p<0.01$ ) but not late transition ( $r=0.01$ , n.s.) and the pattern is reversed for market-based strategies ( $r=0.14$ , n.s., for early as opposed to  $r=0.21$ ,  $p<0.01$  for late transition). We next discuss formal support for our hypotheses through inferential statistics.

Hypothesis 1 predicts that reliance on managerial networking will decrease from early (1993) to late (2001) transition. Overall, the descriptive data pattern is supportive of this. We summarize these results in Table 4. Specifically, for the non-overlapping firms, managerial networking intensity decreased from early transition ( $M=25.30$ ,  $s.d.=15.15$  in 1993) to late transition ( $M=10.08$ ,  $s.d.=9.16$  in 2001). The data are similar for common firms across transition stages: managers spent less time networking as the transition progressed, with a sharp decrease from early transition ( $M=23.68$ ,  $s.d.=15.89$  in 1993) to late transition ( $M=6.00$ ,  $s.d.=1.38$  in 2001). We tested this hypothesis for both the non-overlapping ( $n=117$  for 1993 and

**Table 2** Descriptive statistics and zero-order correlations for early transition (1993)

Variable	Mean	s.d.	1	2	3	4	5	6
1 Firm age (in years)	5.99	8.71						
2 Number of organizations the manager worked for	3.25	1.51	-0.13					
3 Full-time employees	24.49	53.70	0.44	-0.10				
4 Firm type	1.73	0.79	-0.16	-0.02	-0.03			
5 Networking intensity	25.30	15.15	-0.15	0.09	0.05	0.15		
6 Market-based strategies	2.43	0.76	-0.10	0.24*	0.01	-0.27**	0.05	
7 Average growth: sales and number of employees (2 yrs)	1.12	2.02	-0.19	0.31**	-0.04	0.02	0.26**	0.14

Note. *N* is between 104 and 117. Firm type is coded 1 for Manufacturing and 2 for Service.

\* $p<0.05$ ; \*\* $p<0.01$ .

**Table 3** Descriptive statistics and zero-order correlations for late transition (2001)

Variable	Mean	s.d.	1	2	3	4	5	6
1 Firm age (in years)	9.02	6.69						
2 Number of organizations the manager worked for	3.12	1.50	-0.02					
3 Full time employees	47.08	51.91	0.09	-0.18				
4 Firm type	1.82	1.14	-0.01	-0.02	-0.19**			
5 Networking intensity	10.08	9.16	-0.08	-0.09	0.19**	0.12		
6 Market-based strategies	3.19	0.88	-0.06	0.08	0.15*	-0.19**	0.07	
7 Average growth: sales and number of employees (2 years)	0.49	1.01	-0.12	0.05	0.18*	-0.12	0.01	0.21**

Note. *N* is between 174 and 182. Firm type is coded 1 for Manufacturing and 2 for Service.

\* $p<0.05$ ; \*\* $p<0.01$ .

**Table 4** Comparison of networking intensity and market-based strategies in early and late transition

Variable	Non-overlapping firms			Common firms		
	Early (1993)	Late (2001)	<i>t</i> -test	Early (1993)	Late (2001)	<i>t</i> -test
Networking intensity	25.30 (15.15)	10.08 (9.16)	10.61***	23.68 (15.89)	6.00 (1.38)	3.99***
Market-based strategies	2.43 (0.76)	3.19 (0.88)	7.73***	2.38 (0.73)	3.00 (0.99)	3.42**

Note. Means are provided, with standard deviations in parentheses. Sample sizes are 287 (networking intensity) and 298 (market-based strategies) for non-overlapping firms. Results for common firms are based on 19 firms for networking intensity and 20 firms for strategy.

\*\*  $p < 0.01$ ; \*\*\*  $p < 0.001$ .

$n=182$  for 2001) and the common ( $n=19$ ) firms across the two time periods. For the unique firms, the independent samples *t*-test indicates that the decrease in time spent to develop and maintain business contacts was significant ( $t=10.61$ ,  $p < 0.001$ ). This is also the case for the common firms, where the matched *t*-test supports the significance of the difference ( $t=3.99$ ,  $p < 0.001$ ). Combined, these results provide support for Hypothesis 1.

Hypothesis 2 predicts that managers would increasingly emphasize market-based strategies as the transition progressed. Indeed, managers in non-overlapping firms report that their emphasis on market-based strategies increased over time ( $M=2.43$ ,  $s.d.=0.76$  in 1993 vs  $M=3.19$ ,  $s.d.=0.88$  in 2001), and the pattern was similar for common firms across transition stages: managers emphasized market-based strategies less in the early ( $M=2.38$ ,  $s.d.=0.73$  in 1993) than in the latter transition years ( $M=3.00$ ,  $s.d.=0.99$  in 2001). Inferential statistics based on independent and matched *t*-tests, respectively, confirmed our predictions for both non-overlapping firms ( $t=7.73$ ,  $p < 0.001$ ) and common firms ( $t=3.42$ ,  $p < 0.01$ ). The data support our second hypothesis.<sup>2</sup>

Hypotheses 3 and 4 predict that networking intensity and market-based strategies would have a differential influence on firm growth for early and late transition. Given the contingent nature of these hypotheses, we employed an analytical approach suited to modeling variation in firm growth as an interactive relationship whereby the efficacy of a given strategic focus (managerial networking intensity vs market-based strategies) is contingent upon environmental context (early vs late stage transition). This approach has been commonly used to model contingent theoretical relationships in the strategy and international management literature (e.g., Drazin & Van de Ven, 1985; Hewett, Roth, & Roth, 2003; Schoonhoven, 1981).

We used hierarchical multiple regression to test Hypotheses 3 and 4 (Aiken & West, 1991). As with prior studies examining early and late phases of institutional transitions (e.g., Steensma et al., 2005), we used a dichotomous variable to indicate the sample to which a firm belonged (with 0 for early and 1 for late transition). The predictors and the outcome variables were standardized to facilitate the interpretation of results. We created interaction terms by multiplying each of our predictors (managerial networking intensity and market-based strategies) with the dichotomous variable capturing the transition phase. We introduced our control variables, predictors and interaction terms in separate steps.

As presented in Table 5, the model containing the interaction terms (see Model 3) was significant, and explained additional variance in firm growth beyond the direct effects ( $F=5.73$ ,  $p < 0.001$ ,  $\Delta F=3.42$ ,  $p < 0.05$ ). One of the interaction terms (networking intensity by transition phase) was significant and in the predicted direction, as revealed by the standardized regression coefficient ( $\beta=-0.23$ ,  $p < 0.05$ ). Specifically, as compared with our baseline transition period (early stage, 1993), managerial networking intensity during the late transition phase had a significantly lower impact on firm growth. Importantly, the interaction effect size ( $\Delta R^2=0.02$ ) was within the typical range of 0.01–0.03 found in non-experimental studies (Champoux & Peters, 1987). Stated differently, interaction terms are difficult to detect in field studies, and the fact that our interaction was significant and explains variance in firm growth reflects the existence of a substantive phenomenon. Overall, this information provides support for Hypothesis 3, which predicted that managerial networking would have a greater impact on growth than market-based strategies early in a transition. The interaction term crossing market-based strategy with transition phase was not significant ( $\beta=-0.05$ ,  $p < 0.05$ ), indicating lack of support for Hypothesis 4,



**Table 5** Interaction of managerial networking intensity and market-based strategies with transition phase on firm growth

Predictor variables	Firm growth		
	Model 1	Model 2	Model 3
	$\beta$	$\beta$	$\beta$
<i>Step 1 (Control variables)</i>			
Firm age	-0.21***	-0.15*	-0.15*
Number of organizations worked for	0.18**	0.16*	0.15*
Full time employees	0.10	0.09	0.10
Firm type	-0.03	-0.02	-0.01
<i>Step 2 (Predictors)</i>			
Networking intensity		0.19**	0.32**
Market-based strategies		0.14*	0.16*
Transition phase <sup>a</sup>		-0.14 <sup>†</sup>	-0.09
<i>Step 3 (Interaction terms)</i>			
Networking intensity $\times$ transition phase			-0.23*
Market-based strategies $\times$ transition phase			-0.05
<i>F</i>	5.32***	6.27***	5.73***
$\Delta F$	—	7.02***	3.42*
$R^2$	0.08	0.15	0.17
$\Delta R^2$	—	0.07	0.02

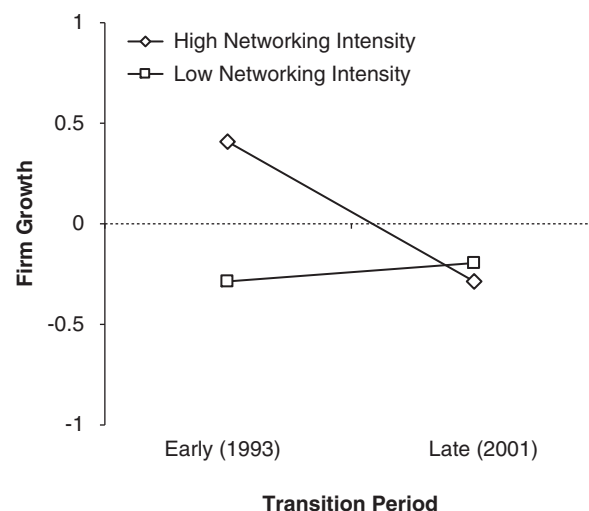
Two-tailed p-values: <sup>†</sup>p<0.10; \*p<0.05; \*\*p<0.01; \*\*\*p<0.001.  
N=249–258.

<sup>a</sup>Transition phases coded with 0 for early (1993) and 1 for late (2001) transition.

which predicted that market-based strategies would have a greater impact on growth than managerial networking intensity later in a transition (see Figure 2 for the interaction plot). In sum, our results provide support for three of our four hypotheses.

### SUMMARY AND DISCUSSION

Our results generally support the premise that, as the transition process unfolds, strategic behavior changes and so do the determinants of SME growth. Early in a transition managers spend a great deal of time (24 h per week on average) developing and maintaining their networks, whereas the importance assigned to market-based strategies is rather modest. Later, this pattern reverses, as managers spend much less time networking (around 10 h per week) and assign more importance to market-based strategies. While managerial networking intensity is a stronger predictor of firm growth early in a transition, this influence wanes over time. Contrary to our expectation, the increased importance of market-based strategies later in a transition is not associated with firm growth. In the sections that follow we discuss some



**Figure 2** Interaction between networking intensity and transition period.

Note. Transition periods on the abscissa, from early (1993) to late transition (2001). Firm growth on the ordinate. Networking intensity with squares representing low and diamonds representing high levels of this activity.

possible explanations for our findings, and comment on the theoretical and managerial implications for IB researchers and practitioners. It is

important to note at the outset that our discussion about the causal mechanisms underlying our findings is necessarily speculative. While our study is among the first to empirically probe the theorized links between networking, strategy and performance during early and late phases of an institutional transition, and reveals significant associations between important aspects of firm behavior and performance over time that are generally consistent with extant theory, further study is needed to definitively rule out alternative explanations and establish causality. We address these points more fully in the passages that follow.

Our findings reconcile the social networks and strategic management perspectives by suggesting that a firm's strategic mix will vary, depending on the stage of an institutional transition. Namely, we argue that in the early years of a transition market-based strategies do not matter much, because coherent strategies are difficult to formulate and implement in environments characterized by upheaval and discontinuous change. In such a context managerial time is better spent developing and maintaining professional and social networks. Such networks can provide timely information and access to resources that may be critical to the survival and growth of SMEs in transition economies (Batjargal, 2003; Peng & Heath, 1996). But as economic reforms and new institutions take shape, the competitive environment stabilizes, and it becomes easier for a manager to assess their firm's situation accurately and develop appropriate strategies. At this point, managerial networking intensity declines and market-based strategies become a more important managerial focus. Theory also predicts that coherent market-based strategies should begin to outweigh personal connections as a source of competitive advantage during the latter phase of a transition (Peng, 2003), although our study found no evidence of this.

Several aspects of institutional transition processes may have a bearing on what strategies and/or managerial activities have the most impact on performance, and why. Logically and theoretically one might reason that, as market institutions mature, market-based strategies become more valuable, whereas the value-creating potential of relationship-based assets diminishes (Peng, 2003). Changes in the strategic mix employed by SMEs may be partly explained as a reaction to intensified competition in the marketplace, which may increase the need to differentiate based on new products, marketing and efficient production

technologies. The increased importance that managers assigned to certain aspects of strategy, particularly those related to marketing/advertising, production and logistics, may also reflect improvements in infrastructure and changes in the business environment that occurred during this time (e.g., larger numbers of marketing/advertising firms and improved local expertise; better physical infrastructure, such as roads; technological innovations in production and logistics). In other words, higher emphasis on marketing/advertising, production and logistics may simply reflect the fact that those elements of strategy become more feasible, and perhaps easier to implement, as a country's institutional environment matures. Our findings support this reasoning. However, the increased managerial focus on market-based strategies, which we correctly predicted, was not associated with higher firm growth. One explanation may simply be that, while managers had shifted their strategic focus during the latter stage of the transition, the performance implications of that shift had either not yet emerged or were not captured in the measure we used (firm growth).

A more subtle explanation may relate to the notions of managerial learning and the legitimacy of alternative methods of competing. Put simply, managers rely on managerial networking early in a transition because they have been conditioned by the previous institutional context, and this is the only way they know how to do business. In the parlance of institutional theory, networking is imbued with cognitive legitimacy, since it is consistent with prevailing norms of managerial behavior, and viewed as a natural and appropriate mode of operation (Campbell & Pedersen, 1996; Meyer & Rowan, 1977). Likewise, the functional benefits of such behavior (e.g., access to information, resources) provide pragmatic legitimacy (Suchman, 1995). But a significant change in the institutional context may diminish the relevance of such behavior as a source of competitive advantage (Newman, 2000). Concurrently, institutional upheaval introduces new players (e.g., foreign firms, new domestic leaders) into the social, political and economic milieu, who offer new ideas and the possibility of change (Greenwood et al., 2002). As a transition progresses, managers are exposed to alternative modes of competing via the increasing presence of MNEs, with which they must vie for customers and markets, and the proliferation of Western-style training and MBA programs. During the early stages of a transition managers may have

difficulty learning and adopting new competitive methods, because they may lack the necessary absorptive capacity to understand them fully and/or adapt them to the local context (Cohen & Levinthal, 1990; Newman, 2000). But as the institutional environment stabilizes during the later stages of a transition a social consensus begins to emerge about the new values, norms and assumptions that will underpin economic activity (Newman, 2000). With the spread and legitimation of new competitive methods, managers may be more likely to use and adapt them to their own situations. Consequently, SME strategies, initially centered on extensive personal networking, may become more multifaceted. As market-based strategies become more widespread, they become objectified, gaining social consensus as to their value in the new institutional context, and diffuse even further (Suchman, 1995). Organizations that adopt such practices thus “increase their legitimacy and survival prospects, independent of the immediate efficacy of the acquired practices” (Meyer & Rowan, 1977: 341). In other words, SMEs may focus on market-based strategies to enhance their legitimacy in the newly emerging institutional environment, thereby improving their symbolic performance (positive social evaluations), even though the substantive performance benefits (growth, profits, market value) of such practices may not be obvious or immediate (Heugens & Lander, 2009). At the same time, managerial solutions relied upon previously may be delegitimized, especially to the extent that the emergence of strong market-oriented institutions renders them obsolete (Newman, 2000). In sum, the co-evolution of managerial behavior, firm strategy and market institutions may be best understood by drawing on multiple theoretical perspectives, including strategic management, institutional theory, social networks and organizational learning.

### Practical Implications

For policymakers in formerly planned economies, one of the most urgent tasks is to promote private sector development and entrepreneurship as a means of spurring innovation, economic growth and employment (Danis & Shipilov, 2002). A better understanding of what strategies are utilized by SMEs at different points during a transition process, and why, can provide insights into how policy might best be tailored to these tasks. Early on, managerial networking can provide links to knowledge and resources that allow enterprise managers

to better predict and control their environments (Peng & Heath, 1996). Thus, until market institutions are firmly established, entrepreneurial use of networks might be encouraged and facilitated by policymakers. At the same time, SME managers should be made aware that network-based strategies may be less viable over time, and should thus be encouraged to develop market-based strategies that may be increasingly valuable as market institutions mature. As we discussed previously, this value may have more to do with imbuing SMEs with legitimacy in the new institutional context than with immediate and quantifiable performance benefits.

Benefits may derive not from the technical or operational efficiency of the strategy itself but from the more subtle effect of bringing the organization into alignment with newly legitimized elements of the institutional environment, thereby reducing turbulence, maintaining stability and creating conditions for survival and eventual growth (Meyer & Rowan, 1977). Although managers of larger firms may learn such methods via foreign partnerships and Western-style training and education (Steensma et al., 2005), it is unclear whether such knowledge is appropriate to the context of SMEs, which face unique challenges relative to larger firms, and whether SME managers have the same exposure to market-based strategies as do their counterparts in larger firms. Consequently, policymakers might consider how to promote strategies tailored to SME managers in particular. In doing so, it is important to realize that networking and market-based strategies are not mutually exclusive. Indeed, they may be employed simultaneously, and each may provide benefits, as we discussed early in the paper. The important point is that the viability, attractiveness and effectiveness of each approach may be affected by changes in a country's institutional environment over time. In this sense, strategy may be conceived as a dynamic mix of elements that should be coherent yet flexible.

MNEs seeking to do business in transition economies are also advised to conceive of their strategies in a co-evolutionary perspective. Although further research is needed to establish whether our findings are generalizable to MNEs, it seems reasonable to assume that as the rules of the game evolve in transition economies so will the competitive norms for all firms who compete in them. Early in the transition process, foreign firms may need to tailor their strategies to the institutional environment by developing their own networking

capabilities, but may later be able to implement more easily strategies developed in their home markets.

### Limitations and Future Research Directions

Our study provides some of the first empirical evidence about whether and how strategic orientations of entrepreneurs change during institutional transitions, and considers the implications of this for firm growth. While our findings were mostly consistent with the extant theory in this area (cf. Peng, 2003), further research is needed to establish the causal mechanisms underlying our results, to rule out alternative explanations, and to obtain a more finely grained understanding of the links between strategic choice and institutional change. For example, the theory on which our study is based posits that high performance is a consequence of matching firm strategy to institutional context. It seems reasonable to assume, however, that a firm's strategic activities may be partly determined by prior performance (i.e., higher-performing firms may have more resources available to engage in either networking or market-based strategies). Similarly, a reduction in managerial networking intensity is theorized to occur, because returns to networking diminish as institutions mature (Peng, 2003). However, it is also possible that managers simply become more efficient at networking over time (perhaps as a result of improved technology, such as e-mail), and hence require less time to achieve the same results. Conversely, managers may simply have less time to talk to people as the transition progresses, because there is more economic activity going on in a liberalized, market-based economy. While the variables we studied are important in their own right, the constraints of our survey instrument and dataset prevented us from examining additional facets of networking and strategy, or from using more objective measures to obtain these data. Although our measure of networking intensity had a significant positive correlation (0.35) with how much managers use business contacts and professional associations for market-related information, future work may explore the extent to which our perceptual measures correlate with more objective assessments of networking intensity and market-based strategies. Similarly, the use of time period as a proxy for institutional change, while justified by the data (Table 1), may be viewed as a shortcoming to the extent that it does not distinguish among specific elements of

institutional change. Therefore longitudinal studies that track multifaceted aspects of networking, strategy, performance and institutional change over time are needed to assess these potentially complex relationships.

As with all studies employing non-random samples, sampling bias and generalizability are potential concerns. The Methods section describes several elements of our sampling plan and analyses that were implemented to minimize these concerns. For example, we tested Hypotheses 1 and 2 using both common and unique firms across the time periods (early and late transition) and found similar results, thereby reducing the potential for sampling error as a possible explanation for our findings. Although we were unable to employ a similar approach for Hypotheses 3 and 4, we did combine our 1993 and 2001 samples, and using time period as a moderator variable allowed us to control for several potential covariates (e.g., firm size, age) across rather than within samples, thereby reducing the potential for sampling bias along key dimensions. Even so, future studies employing random samples will be needed to address these issues completely.

As previously described, our measures of networking intensity, market-based strategy and firm growth were reported to the interviewer by a single respondent, and based on executives' perceptions. This raises the issue of common method variance and single-respondent bias. To diminish these concerns, we checked empirically for common method bias using the Harman one-factor test (Podsakoff & Organ, 1986), consistent with other studies where data were collected from the same source (e.g., Petersen, Pedersen, & Lyles, 2008). This test provided no support for a one-factor solution, and revealed that the first factor explained a limited amount of variance (28.6 for sample 1 and 25.5 for sample 2), suggesting that common method bias is unlikely to be a major concern for our data. In addition, we used several practices emphasized more recently by Podsakoff et al. (2003) for situations where data cannot be obtained from several respondents (e.g., creating methodological and psychological separation in the measurement instrument: 887–888). Methodological separation was obtained by varying the response formats for predictor and outcome variables (i.e., number of hours, four-point scales and percentages, respectively). Survey items for the predictor and outcome variables were also placed in separate sections of the survey, and the respondents were interviewed instead of reading the questions themselves. The





psychological separation thus created did not allow our participants to access their prior responses. These practices, coupled with the fact that we guaranteed confidentiality of the responses, are likely to diminish consistency motives, demand characteristics, and social desirability issues, and to enhance the accuracy of our responses (Podsakoff et al., 2003). We also sought to assure the quality of our data via a focus on smaller, non-diversified firms where we may expect key informants to be knowledgeable about the strategy and performance of their organizations.

The first section of this paper provides a compelling rationale for using Hungary as a case study that may provide insights into the evolution of SME strategies in other transition economies, but we acknowledge that multi-country studies examining a variety of institutional contexts will be necessary for further theory development. For all these reasons, our findings and interpretations must be considered tentative. We next offer suggestions for future research that have the potential to overcome these limitations and build on our work.

Although our results suggest that managerial networking is more highly associated with growth during the early stages of an institutional transition, more in-depth examination of this issue is warranted. For instance, is networking behavior primarily informal, perhaps aimed at acquiring information or political influence? Or might such behavior be indicative of a formal mode of organization (Jarillo, 1988), geared for example toward developing vertical and/or horizontal alliances with business partners with the objective of procuring resources and/or sharing risks? Research along these lines could reveal the specific mechanisms by which managerial networking influences performance. Although we suspect that managers were afforded better access to resources and information, our data did not allow us to test this explicitly. With regard to the increased importance assigned to market-based strategies over time, we theorized that this may be driven by increased exposure to market-based modes of competing via the increased presence of MNEs (both partners and competitors) and/or exposure to Western-style training. We employed post-hoc analysis using proxies for Western exposure (e.g., founder of Hungarian or foreign descent, last job working for foreign firm, foreign partnerships, percentage sales in Western countries, access to foreign business people) to examine whether this was associated with either strategic orientation or performance but

found only one significant correlation, which was opposite our prediction (growth in 2000 was correlated 0.31 with a founder of Hungarian descent). Nonetheless, we believe that this remains an interesting topic for future research. Additional studies with more precise measures may be needed to explore this topic in more detail.

A key insight from this study is that, as the institutional environment changes, there are modifications in both managerial behavior and the strategic orientation of firms that may impact on firm growth. Our findings should be generalizable to other transition economies to the extent that they share common institutional and economic legacies related to central planning. Yet additional research is needed to determine whether the results obtained here hold in other contexts. Our study focused on indigenous SMEs, which are critically important to economic growth, but did not examine larger domestic firms or international firms. And while we focused on SME growth, which is an essential aspect of economic development and job creation in transition as well as developed economies, it would be worthwhile to examine other aspects of firm performance as well. The research questions examined here should also be extended to other institutional contexts. For example, one potentially important issue to consider in future research is speed of transition. While Hungary and other post-communist European countries experienced relatively rapid transitions, China's transition has been more evolutionary, and it may be that our findings are less generalizable to that context. Will the pattern we observed hold only in countries undergoing rapid institutional change? And might we also observe an evolution from relationship-based to competencies-based strategies in industries that are undergoing discontinuous change? Answers to these questions would establish the boundary conditions under which our propositions hold, and further extend and integrate the theoretical perspectives adopted in this paper.

### Conclusions

The IB literature has paid relatively little attention to how institutions change and evolve (Jackson & Deeg, 2008), and the way institutional changes translate into behavioral changes at the individual and firm level has also been largely unexplored (Meyer & Peng, 2005). This study begins to address these gaps in the literature by tracking institutional changes in a transition economy, empirically examining whether and how SME strategies evolve

during the transition process, and assessing the implications for firm growth. Our results are partly consistent with prior studies (cf. Batjargal, 2003; Copp & Ivy, 2001; Peng, 2004; Zhao & Aram, 1995), which have found networking behavior to be a central aspect of firm strategy in transition economies. We extend such work by providing empirical evidence that managers may be less reliant on networking as market-based institutions mature. We further argue that changes in strategy are concurrently driven by socially constructed norms that legitimize new ways of competing and delegitimize old ones, and by knowledge acquisition and learning, which provide managers with a more diverse set of tools with which to exercise their strategic choices.

The importance of entrepreneurship and SME development for economic development and growth is widely acknowledged in the IB literature, but relatively little empirical work has examined whether and how institutional changes co-evolve with the strategic behaviors of indigenous SMEs, nor has much research investigated the determinants of SME growth during institutional upheaval. Our study sheds light on both of these issues and suggests a potentially fruitful line of research, which is likely to be of critical interest to IB scholars, practitioners and policymakers alike. This study also contributes to the mainstream entrepreneurship literature by providing insights into how the behaviors of entrepreneurs and their firms evolve in dynamic environments, and how such behavior might be linked to firm growth.

In sum, this study applies convergent insights from the strategic management, institutional, networks and organizational learning perspectives in the dynamic context of SME development in transition economies. While IB scholars have theorized about how institutional transitions affect

strategic choice, and have suggested that the importance of personal networks should decline relative to market-based capabilities as the transition process progresses (cf. Peng, 2003) there has been little empirical investigation of this topic until now. Importantly, this research builds on Peng's (2003) suggestion to focus more explicitly on the temporal dimension by employing a longitudinal approach. This study identifies some important factors associated with entrepreneurial growth and performance during institutional transition, and offers theoretically grounded insights that are likely to have important implications for practitioners and policymakers. We hope our study, and some of the questions raised herein, will spur additional work in a broader range of research settings on the dynamic links between strategic choice and firm performance during institutional upheaval.

## NOTES

<sup>1</sup>Although firms with 10 or fewer employees are generally considered micro-enterprises, there is no generally accepted definition of an SME. Our upper size limit of 350 employees was an average of the cutoffs used by the American Small Business Association (500), the European Union (250, and the Hungarian Central Statistical Office (350).

<sup>2</sup>To control for important differences (e.g., firm age, number of organizations the manager has worked for, number of employees and firm type) across our two transition phases, we supplemented our *t*-tests with analyses of covariance, with these four variables used as covariates. Our results indicate that differences in networking intensity and market-based strategies remain significant across transition periods ( $F=98.47$ ,  $p<0.001$  for networking intensity, and  $F=55.93$ ,  $p<0.001$  for market-based strategies).

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## APPENDIX: MEASURES USED IN THE STUDY

### Item descriptions for formative measures:

#### Managerial networking intensity

- In a typical week how many hours do you spend ...
- ... developing contacts (meeting new people) with whom you can discuss business matters?
  - ... maintaining contacts (talking to people you already know) about business matters?

#### Firm growth

- What was the percentage of growth in sales in the last 2 years?
- What was the percentage of growth in the number of employees in the last 2 years?

### Factor analysis results for market-based strategy:

### Loadings

	1993	2001
Please indicate the most important aspects of your competitive strategy ...		
... Effective marketing/advertising	0.66	0.48
... Fast responses to changes in markets	0.62	0.56
... More contemporary, attractive products	0.69	0.58
... Develop and use new/advanced process/manufacturing technology	0.77	0.75
... Develop new/advanced product technology	0.78	0.85

Note. Factor analyses yielded a single factor solution for each time period.

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