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Ressource-based and Organizational Learning Perspectives

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ORGANIZATIONAL TRANSFORMATION IN TRANSITIONAL ECONOMIES:

RESOURCE-BASED AND ORGANIZATIONAL LEARNING PERSPECTIVES

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ABSTRACT

The capitalist and socialist societies of the 20th century assigned firms different roles within their economic systems. Enterprises transforming themselves from socialism to market economies thus face fundamental organizational restructuring. Many former state-owned firms in the transitional economies of Central and Eastern Europe failed, so far. Firms pursued primarily defensive downsizing, rather than forward-looking strategic restructuring as a result of both internal and external constraints on restructuring strategies.

Building on the organizational learning and resource-based theories, we analyze the strategies available to management in privatized, former state-owned enterprises in transitional economies to restructure their organization. In this take into account both internal forces promoting or inhibiting the restructuring process, and external constraints arising in the transition context. A model and testable propositions are developed that explain post-privatization performance. Implications of our research point to the ways in which firms should manage and develop their resource base to transform themselves to competitive enterprises.

Keywords: ENTERPRISE TRANSFORMATION. TRANSITIONAL ECONOMIES. PRIVATIZATION.

ORGANIZATIONAL TRANSFORMATION IN TRANSITIONAL ECONOMIES: RESOURCE-BASED AND ORGANIZATIONAL LEARNING PERSPECTIVES

Since political transition in Central and Eastern Europe (henceforth CEE) began over ten years ago, the effectiveness and performance of former State-Owned Enterprises (SOEs) has been considered one of the chief forces driving the development of these transitional economies (Frydman, Gray, Hessel & Rapaczynski 1999). Governments and international institutions, such as the IMF (IMF et al. 1991), predicted that organizational transformation would be completed by the end of the 1990s. However, this expectation has been largely disappointed (Pucik, 1999; Stiglitz, 1999).

Policy makers focussed on privatization as means to induce restructuring. Yet the change of ownership and the creation of appropriate governance structures is only part of the privatization process. Crucial is what happens within the organization. The needed post-privatization restructuring has proved far more complex than anticipated (Blasi, Kroumova & Kruse, 1997) and rarely happens in former SOEs in transitional economies (Carlin & Aghion, 1996; Whitley & Czaban, 1998; Wright, Hoskisson, Filatotchev & Buck, 1998). Privatization may have produced the necessary organizational restructuring in developed nations (Bishop, Kay & Mayer, 1994; Megginson, Nash & Randenborgh, 1994), but often did not occur in transitional economies. In many instances, the competitive gap between privatized firms in CEE and international competitors has even increased over the past ten years (Pucik, 1999). As a result, some doubt that these firms can achieve global competitiveness (Johnson, Kotchen & Loveman, 1996; Newman, 2000).

Recent research suggests reasons for slow or inadequate transformation of privatized firms. First, many former SOEs in transitional economies are burdened with mediocre assets and managers that lack the skill, resources, and experience to manage firms in competitive market environments (Filatotchev, Hoskisson, Buck & Wright, 1996; Nellis, 1999; Peng & Heath, 1996). Second, many firms in CEE lost their traditional markets to new competition, vanished international trade relations, and declining purchasing power (World Investment Report, 1995; Linz & Krueger, 1998; Meyer, 1998a; Uhlenbruck, 1997). Third, the legal and institutional framework and the capital markets to support organizational transformation are lacking (Spicer, McDermott & Kogut, 2000).

However, there is evidence for substantial transformation and entrepreneurial activity of some privatized SOEs, just as there are more optimistic evaluations of the economic development in CEE (e.g., Fischer & Sahay, 2000). Firms acquired by foreign, strategic investors improve efficiency and performance based on the capital, technological resources, and management skills provided (World Investment Report, 1995; Uhlenbruck & Castro, 2000). Moreover, a small number of firms privatized domestically have restructured and improved performance without the support of strategic investors (Johnson and Loveman 1996, Djankov & Pohl, 1998; Frydman et al., 1999; Krueger, 1995; Newmann and Nollen 1998). Case studies have identified privatized firms that have been able to survive and even prosper despite significant competition from global competitors entering now unprotected markets. What has helped these firms was recognizing the strategic threat of these competitors and a reaction built on competitive advantages such as knowledge of local markets and lower costs. Some formerly communist business leaders also have proven to be entrepreneurial and quick to learn from the foreign competition (Djankov & Pohl, 1998; Lyles & Salk, 1996; Peng 2000). Strategic transformation and adaptation of privatized firms in CEE seems possible, but in the majority of firms it is happening much slower than expected (Stiglitz, 1999; Wright et al., 1998).

There is considerable research grounded in economic and financial theories reflecting the emphasis of reform in these countries on intervention on the macro level while insufficiently considering organizational realities (Newman, 2000; Zahra, Ireland, Gutierrez & Hitt, 2000; Meyer 2001). The past ten years have shown the limits of top-down transformation, as evidenced by the inconclusive findings of the literature on the governance of privatized firms in CEE (Bevan, Estrin & Schaffer, 1999, Carlin 2000). More recent research has shown that fundamental organizational change and deep restructuring has to occur before former SOEs in CEE will be able to compete effectively in their home markets and abroad (Antal-Mokos, 1998; Frydman et al., 1998; Newman, 2000).

In view of this state-of the art, we take a bottom-up approach to enterprise transformation. We propose a theory-based model of the transformation of enterprises that focuses on the firm's resources and markets. Based on organizational learning theory and the resource-based view of the firm, we develop a model that identifies variables critical to the transformation of firms in their new context. Organizational learning and the resource-based view are particularly relevant as they account for the history of a firm and address the process of adaptation to a dynamic environment in which competitive advantage has become critical for firm performance (Barney, 1991; Fey & Denison, 1999; Spicer, et al., 2000). This perspective also allows us to focus not only on product but also on factor markets which is critical because both are underdeveloped in CEE. This theoretical discourse—and future empirical testing—provides implications for the management of privatized firms in transitional economies.

We begin by examining the current literature on organizational transformation in CEE. Then, resource-based and organizational learning theories are introduced as the basis for the subsequently developed model. Following, we suggest a number of propositions regarding the relationship between key variables and firm performance. Finally, we present implications for research and management.

ORGANIZATIONAL TRANSFORMATION IN CENTRAL AND EASTERN EUROPE

There is little agreement in the literature on organizational transformation regarding the changes required for former state-owned enterprises to survive in the post-transition economy (Linz & Krueger, 1998: 13). Restructuring primarily through downsizing of output, employees, energy use, and assets was common during the past decade. Because of traditional overemployment at enterprises in socialist countries in combination with declining sales during the first years of transition[1], the initial focus of research was on restructuring the former SOEs primarily by reducing employment. Unfortunately, public statistics rarely discriminate what parts of firms were downsized, limiting implications of the research based on these data.

Based on an analysis of privatization cases studies, Carlin and Aghion (1996) concluded that firms have neither the capital nor the skills necessary for deep restructuring. Even in Hungary, considered to be the most advanced of the transitional economies, privatized firms show little change in products and markets served nor did they implement the radical organizational changes necessary (Whitley & Czaban, 1998). Also, Hungarian companies largely did not engage in new product development or technology upgrades (Bonin & Abel, 1998). The World Bank (1996) summarizing the evidence, stated that most privatized firms in CEE rarely move beyond the early stages of transformation. Rather, former SOEs implemented defensive downsizing in reaction to external change, and did not engage in deeper strategic restructuring.

Nevertheless, despite discouraging reports for many privatized firms in CEE, numerous case studies show that some privatized firms have engaged in strategic restructuring and thereby developed competitive advantage and sustained positive performance despite international competition. These case studies suggest that CEE local firms may be able to compete effectively without support from foreign investors. For example, soft-drink maker Pikra competes successfully with Coke and Pepsi on price and concentrates efforts in the eastern region of Russia (McKay, 1999). The firm originally learned the business as a bottler for Pepsi, but now is an independent competitor. Similarly, Raba, a formerly vertically integrated Hungarian truck manufacturer focused on those parts of its value chain were its technology was the most current (Dawar & Frost, 1999). By doing so, it achieved success by manufacturing and selling tractor axles even in international markets.

Djankov and Pohl (1998) examined 21 case studies from Slovakia and found that deep restructuring is quite possible in the absence of foreign investors and government support, and with the old management in place. Firms there had attracted capital by selling unused assets, selling shares to outside investors, and reinvesting the capital in new technology. Also, new skills were learned via foreign partnerships. Krueger (1995) interviewed managers in 34 former SOEs in Russia and found that firms, particularly in the food processing industry, improved cash flow by building their own distribution system. Overall, he concluded that many firms implemented sophisticated long-term strategies. Frydman et al. (1998) found for a sample of over 300 current and former SOEs that privatized firms improved performance because of their entrepreneurial adaptation of products to new market opportunities compared to firms that continued to be owned by the state.

While the largely economics driven research on privatization observes firm restructuring as an outcome of changes in governance, it provides few implications for the management of privatized firms. In particular, prior literature on privatization in transitional economies does not develop hypotheses regarding the relationship of specific transformational efforts and performance. A notable exception is the work by Peng and Heath (1996). They develop a model of firm growth in transitional economies relative to predictions made by Western research on growth as a strategic choice. The model proposes boundary blurring between firms and institutions as a network-based growth strategy. We draw on their work in developing our model, in particular their description of a stylized SOE in a transitional economy. Overall, we conclude that the literature is largely descriptive and lacks theoretical models and normative propositions.

A MODEL OF POST-PRIVATIZATION RESOURCE DEVELOPMENT

Examples of successful transformation indicate that privatized firms in CEE can and make strategic choices. Selecting a strategy requires that management understands internal strengths and weaknesses and evaluates opportunities and constraints of the environment (Andrews, 1980; Chandler, 1962; Child, 1972). We follow this fundamental insight in strategic management, but

[1] Even 10 years after transition began in CEE, GDP for most states is still below that of 1989. Russia's 1999 GDP, for

below build on the more formally developed theories of organizational learning and the resource-based view of the firm to explain transformation of privatized firms in CEE. In particular, the resource-based view provides insights in the analysis of firm strengths and weaknesses as well as the development of firm resources and capabilities as a basis for taking advantage of market opportunities (Barney, 1986, 1991; Dierickx & Cool, 1989; Wernerfelt, 1984). The organizational learning theory (Fiol & Lyles, 1985; Huber, 1991; March & Levitt, 1999) provides insights how firms understand and evaluate their environment.

While the industrial organization paradigm focuses on industry characteristics to explain differences in firm performance, the resource-based view emphasizes performance differences based on firm heterogeneity. Firms vary in their resources and in the capabilities derived from those resources. Resources that are valuable, unique and difficult to imitate can provide the basis for firms' competitive advantages (Amit & Schoemaker, 1993; Peteraf, 1993). In turn, these competitive advantages allow firms to earn above normal returns (Barney, 1991). Firms employ both tangible resources (e.g., buildings, financial resources) and intangible resources (e.g., human capital, reputation) to develop and implement competitive strategies. However, intangible resources are more likely to produce a competitive advantage because they are often rare and socially complex, making them difficult to imitate (Black & Boal, 1994; Rao, 1994).

The organizational learning literature builds on insights in sociology and organizational theory and complements the resource-based view. An organization learns if its range of potential behaviors changes through its processing of information (Huber, 1991). A key aspect of organizational learning is knowledge acquisition, which includes drawing on existing knowledge within the firm, gaining understanding from experience or observation, and environmental scanning. Knowledge can be classified into articulable and tacit (Lane & Lubatkin, 1998). Articulable knowledge can be codified and thus can be written and more easily transferred (Liebeskind, 1996). Tacit knowledge, however, is not articulable and therefore cannot be easily transferred (Kogut & Zander, 1993; Teece, Pisano & Shuen, 1997). Tacit knowledge is often embedded in uncoded routines and in the firm's social context. In fact, it is partially embedded in individuals' skills and in their collaborative working relationships (Nelson & Winter, 1982; Szulanski, 1996).

However, the learning firm also interprets new information and distributes and stores knowledge within the firm (information processing). A necessary condition to interpret and utilize

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instance, is forecasted to be down 45% on 10 years ago (Transition Report, 1999).

new information is prior related knowledge (Cohen & Levinthal, 1990). In point of fact, firms must have the appropriate absorptive capacity in order to select, acquire and integrate knowledge from other sources. Prior related knowledge contributes to a firm's absorptive capacity. Thus, in order to learn appropriate knowledge, firms may have to develop an adequate absorptive capacity (Cohen & Levinthal, 1990).

Resources in the form of managers and other employees, knowledge, firm capabilities (processes/routines of the firm), and firm-specific assets build the basis for firm performance, evolution, and sustainability (Conner, 1991; Peteraf, 1993). The growing popularity of the resource-based theory as an explanation for differences in performance across firms has led to increasing focus on the effects of resources on a firm's ability to generate rents. Of particular interest herein is the development of dynamic capabilities (Teece et al., 1997) that in turn allow firms to develop new resources and enable it to take advantage of new opportunities, i.e., there is path dependence between existing and new resources of the firm (Prahalad & Hamel, 1990).

Organizational learning and the resource-based view are interrelated because the former provides explanations for the firm's ability to recognize and develop needed resources and capabilities. The outcome of organizational learning is an enhancement of intangible resources and thus an increase in possible strategies the firm can employ (Hitt, Bierman, Shimizu & Kochhar, 1999; Huber, 1991).

Building on organizational learning and resource-based theories, we propose a model of the transformation of privatized firms in CEE (see Figure 1). Considering the inadequate condition of SOEs relative to the efficiency of Western firms, earlier research suggested gradual transformation of privatized firms building on old relationships between firms and institutions (Peng & Heath, 1996). We argue that effective restructuring necessitates a coherent package of complementary changes that build on existing strengths of the firm and the ability of organizations to learn and develop. The firm-external environment is treated as an exogenous variable. Firms in transitional economies are facing an environment characterized by major political and economic changes, an uncertain legal and institutional framework, and undeveloped factor and product markets. Because of the nature of newly privatized firms, they rarely have the power or ability to change their environments; thus adaptation to these conditions, i. e., creating fit between the firm and its environment, is a critical variable in the model.

Insert Figure 1 here

Firms in transitional economies plunged into the market economy with a bundle of resources brought together to serve the needs of the central-plan economy. Resources were allocated in part in implementing the central plan, and in part through unintended incentives created by the plan regime. In 1989, the typical state-owned firm had excess employment (due to lack of incentives to economize on labor costs), excess inventories (due to lack of accounting for capital costs), dated physical equipment, extensive social services, and an uncompetitive product portfolio, especially for consumer goods (due to lack of market pressures) (Berliner 1952, Kornai 1980). Firms were highly integrated both vertically (due to high transaction costs of inter-firm-relations, which had to go through central ministries) and horizontally (due to the focus on economies-of-scale of socialist industrialization policy) (Meyer 1998b, Peng and Heath 1996).

Employees were highly qualified in technological skills, based on generally high standards of education in sciences and technical professions. Managers were furthermore experienced in using relationships with political authorities, notably the communist party and the central plan authorities to the advantage of the firm (Ledeneva 1999). Moreover, the real existing socialism required firms to engage in informal, sometimes semi-legal, interactions with each other to overcome shortages. Managers thus developed considerable political networking skills (Martin 1999), which they continue to utilize (Peng, in press), but lack experience in managing in a market environment (Lawrence and Vlachoutsicos 1990, Pearce 1991, Puffer, Levintan, Walck & Waterman 1994, Fey & Bjoerkman, 1999).

This bundle of resources, while serving survival under socialism, is profoundly different from the requirements of a market economy. Firms thus have to reconfigure their resources dramatically, and learn to operate successfully in the new context. Because the firm may not have appropriate resources to adapt to change and take advantage of new opportunities, and because factor inputs, including management and capital, are not easily available, the firm has to spend significant efforts in attracting or developing new resources, including financial resources. Because of shrinking markets and hard budget constraints, privatized firms have significantly reduced financial reserves (Wright et al., 1998).

We use the term resource attraction rather than acquisition here to indicate that the lack of funds may force the firm to find ways to utilize scarce resources, possibly without actual ownership, a strategy considered important for entrepreneurial firms in developed markets too (Timmons, 1994). Resource upgrades refer to general improvements of existing resources of the firm, such as employee training.

The high degree of vertical and horizontal integration and excessive physical resources of privatized firms in CEE also suggest that firms may divest significant parts of their business. Divesting assets may also produce financial resources needed to attract other resources. Even with adequate financial resources, firms also need to upgrade their existing capabilities with particular emphasis on the firm's human capital. Existing and new resources need to be integrated, i.e., honed to serve specific market opportunities (Teece et al., 1997), to achieve fit between the firms resource, strategy, and environment.

The need for strategic fit between the organization and its environment is a fundamental management concept in the organization literature (Chandler, 1962; Lawrence & Lorsch, 1967; Porter, 1996). The importance of strategic fit for firm performance has also been discussed for firms in transitional economies (Gates, Milgrom & Roberts, 1996; Tan & Litschert, 1994). Milgrom and Roberts (1990) argue that as firms establish modern manufacturing methods, strategic, organizational and marketing variables have to be adapted for the firm to be efficient (also see Milgrom & Roberts, 1995; Parthasarthy & Sethi, 1993). Privatized firms in CEE often need to make substantial changes throughout the organization in order to adapt to significant change in the environment. Thus, the problem of fit becomes critical. For instance, if the firm modernizes technology, its traditional organizational systems—based on Fordist mass production (Sorge, 1993)—may be incapable of taking advantage of technology that is used to best effect only with very different, flexible work arrangements. Because change in privatized firms in transitional economies may be so profound, we propound that *the creation of fit between historical resources of the former SOE, newly developed or acquired resources, organizational systems, and market opportunities is critical to successful transformation.*

The following propositions build on this need for fit and provide more detail on the relationships implied in the model. Divesting certain assets while acquiring others or internally enhancing organizational capabilities through knowledge acquisition and learning will strengthen the potential of the firm to develop strategies to take advantage of product market opportunities. Bounded by their absorptive capacity, firms can process information acquired from markets to learn about opportunities and identify the required resources (Huber, 1991). Likewise, firms identify which resources are available from factor markets and acquire those needed or develop them internally (Dierickx & Cool, 1989). Because of the inefficiency of factor markets in transitional economies, firms able to attract needed resources have the opportunity to create competitive advantage (Barney, 1986). We look at this process of resource development starting with downsizing and then progress to upsizing.

RESOURCE RECONFIGURATION

For the socialist SOE, the central plan and bureaucratic control dictated procurement, distribution relationships, and product line (Ericson, 1991; Kornai, 1992; Lawrence & Vlachoutsicos, 1990; Peng & Heath, 1996). After privatization and economic reform, these firms now have to search markets for information on which products are demanded and decide which demand they are best able to fulfill (Swaan 1997). The best opportunities will be those for which the firm has or can build the resources to create value to the customer superior to the competition (Barney, 1991). Because the firm in the past often provided outdated products—and the provision of products depends on the appropriate resources (Wernerfelt, 1984)—it is unlikely to possess all resources needed to produce products that can take advantage of these opportunities. Thus, the privatized firm has to develop new resources internally or identify which to acquire from the factor market, or both.

SOEs in CEE have traditionally provided a number of services unrelated to their main business functions, and have hoarded physical assets, building resource slack (Kornai, 1980; Meyer, 1998b; Peng & Heath, 1996). Privatized firms in competitive markets, now submitted to significant budget constraints, may sell off these slack resources to attract needed resources from factor markets and/or upgrade existing resources (Djankov & Pohl, 1998). As expected, Whitley and Czaban (1998) find in an analysis of 27 cases of business restructuring in Hungary that few firms sold off core units but most closed or sold auxiliary units.

A reduction of products and services offered allows privatized firms to focus on core competences rather than continuing to provide for their community as was demanded by state agencies (Frydman et al., 1998). Thus, strategic reduction of the product portfolio and vertical integration, through spin-offs or closure, allows for deeper organizational transformation than general, operational downsizing (Ericson, 1998; Ernst, Alexeev & Marer, 1996; Meyer, 1998b). Selling selected assets generates funds that can be reinvested in resource acquisition and development to take advantage of specific opportunities. Streamlining the organization may also attract investors and thus financial resources. On the other hand, maintaining obsolete product lines and the associated employment should be least conducive to transformation.

For firms in developed markets, an alternative route to asset divestment may be the utilization of excess capacity by expanding production (Penrose, 1959). However, in transitional economies, shrinking markets, limited market access, and/or new competitors with often higher-quality products at lower prices significantly reduce the privatized firm's ability to sell its full range of products at efficient capacity utilization rates. Thus we suggest divesting excess resources and using the returns to improve the current resource bundle as the more appropriate short-term strategy.

Proposition 1 *Product portfolio restructuring and/or sale of assets outside the privatized firms' core business, rather than general downsizing, support the attraction of needed resources and will be positively related to fit and performance.*

All firms have specific resource endowments (Barney, 1991) but often need further resources in order to be competitive (Hitt, Nixon, Clifford & Coyne, 1999). The need for more resources is particularly acute in newly privatized firms from CEE. Newly privatized firms from CEE generally have critical needs for financial capital and for technical and managerial capabilities. The newly privatized firms from CEE find it difficult to compete in product technologies with firms from developed market countries. Often, they do not have the capabilities to effectively develop and offer new and sophisticated products in sufficient quantity and quality to be competitive with firms from other countries. Therefore, these firms must emphasize resource development.

An efficient way for firms to improve their resources is to invest in complementary assets (Barney, 1988; Hitt, Ireland & Hoskisson, 1999). Competence can build on synergies created between existing and added resources. For firms in transitional economies this may include investments in marketing assets to improve market access, in production facilities, training, etc. to improve the price/quality relationship of products, or in new product development. Because of limited available financial resources, former SOEs are unlikely to invest in all areas simultaneously, but focus in one of these areas.

While the resource-based view makes no direct suggestion on which of these possible areas a firm should focus, investments in resources serving a more efficient utilization of existing resources should be favored. For example, assuming a firm produces a marketable product, but has no adequate distribution network, distribution improvements—and associated sales growth—will increase utilization of the existing productive capacity. In a comparative study, Kogut and Zander (1999) find that socialism does not necessarily reduce technical capabilities of firms, but their separation from the customer severely impedes their ability to adapt to market needs. Investments in marketing may thus be critical for the performance of the privatized firm.

We expect that a gradual change of the privatized firm provides the opportunity for learning and subsequent adaptation. Organizations face rigidities of organizational routines (Nelson & Winter, 1982). These may limit the firm's ability develop new capabilities in business activities that differ significantly from existing activities. Improved market access allows the firm to learn from customers (Kogut & Zander, 1999; Krueger, 1995) and thus more efficiently improve existing products. Better market access and expanded sales based on improved products may enhance the organization's capacity to learn and thus its ability to expand further, eventually developing new capabilities and new products. Above argument matches Ansoff's (1957) suggestion that firms grow first via market penetration and later via new product development.

Proposition 2 *Privatized SOEs attracting resources that complement the current resource bundle of the firm by improving its ability to penetrate the market will improve strategic fit and increase performance.*

Proposition 3 *Privatized SOEs attracting complementary resources that improve their ability to penetrate the market before they engage in new product development will achieve better fit and performance than firms investing in new product development before investing in market penetration.*

ORGANIZATIONAL LEARNING

The learning requirements for privatized SOEs in CEE are daunting. Before transition, they existed as production units within the central plan and now become economic agents as buyers and sellers in a market environment (Meyer, 1998b). To be able to adapt to the new situation, firms have to recognize the changes and understand the impact these changes are likely to have on the firm (Andrews, 1980; Keats & Hitt, 1988). The environmental changes result in new conditions for the firm to which it has to react in new ways, which requires learning.

There are three particular challenges to these learning processes that distinguish the situation of privatized firms in CEE from western firms. First, the disappearing traditional product "markets" makes the identification of new demand an immediate necessity. Second, factor markets, which are limited at best, provide particular challenges to identify the resources needed from external sources (Peng & Heath, 1996). Finally, the socialist experience has equipped firms with little prior knowledge that would allow them to adequately interpret the information acquired to make the optimal decisions on opportunities to pursue, and where to find needed resources (Swaan 1997). That is, insufficient absorptive capacity may hinder critical learning processes at the firm (Cohen & Levinthal, 1990; Fiol, 1996).

Knowledge Acquisition Strategy

The economic and social instability in CEE produces ambiguity and uncertainty regarding the rules of exchange. Thus, rules are largely emergent (North, 1990; Pedersen & Thomsen, 1997). The ambiguity and uncertainty makes the environment difficult to analyze. Yet, firms can enhance their knowledge about new situations by actively and systematically searching for information (Fiol & Lyles, 1985; Huber, 1991). Knowledge about markets allows the firm better adaptation and strategic fit. Systematic knowledge acquisition has been linked to improved performance (Daft, Sormunen & Parks, 1988; Hambrick, 1982).

Traditionally, however, SOEs' relevant sources of information on input and output decisions were state agencies and thus typical environmental information gathering practices are largely absent. Only recently firms began to actively pursue knowledge about their market environments, for instance via environmental scanning or alliances (Djankov & Pohl, 1998, Lyles & Salk, 1996). Invariably changing market conditions, which characterize transitional economies (Newman & Nollen, 1998), increase this need for knowledge acquisition even further. Identification of the status quo in developing product markets and factor markets is essential to improve strategic fit.

Key tools to acquire knowledge are environmental scanning and learning from networks and alliances (Huber, 1991; March & Levitt, 1999). Networks are particularly important for firms in transitional economies, both domestically (Peng and Heath 1996, Child and Marcozy 1993, Stark 1996) and to integrate into international production (Meyer 2000). However, networks between former SOEs may also undermine true transformation. "Webs of mutual support" (Ericson, 1998:104) maintain non-market interaction and barter trade, but not the learning of how to adapt to the market-based economy. Also, these networks provide significant opportunity for negotiating continuation of subsidies and protection, collusion or other unethical transactions, which reduce firm efficiency and transformation of the organization's culture (Broadman 1999, Woodruff 1999).

Still, alliances can be a significant tool for organizational learning if clear and targeted goals are established. This includes alliances with suppliers to overcome problems of factor markets, with customers to learn about opportunities, marketing needs and innovation (Lyles & Salk, 1996). Strategic alliances provide interactive learning opportunities from the experiences of the partner

(March & Levitt, 1999). They help firms develop new capabilities, even tacit components, and build their resource endowments (Lane & Lubatkin, 1998). In particular, privatized firms from CEE are likely to learn the most from foreign firms, in particular if those firms come from a developed country. Such an international alliance permits organizational learning that has a high probability of producing a competitive advantage because it allows the transfer of tacit knowledge. Alliances allow a firm to get close enough to partners to understand even tacit components of their capabilities (Lane & Lubatkin, 1998). However, firms may also learn via observation from successful foreign competitors.

Proposition 4: *Active knowledge acquisition strategies (for the product as well as the factor markets) will be positively related to fit and firm performance.*

Proposition 5: *Active knowledge acquisition strategies are particularly effective if pursued via alliances aimed at specific learning outcomes.*

Proposition 6: *Active knowledge acquisition strategies are particularly effective for former SOEs in industries with foreign competitors.*

Organizational learning theorists distinguish between observational and experimental learning (Weiss, 1990). Knowledge acquisition from alliance partners or environmental scanning leads to observational learning, encouraging imitation (Huber, 1991). Imitative processes may be of particular importance in early stages of transformation and improve the former SOE's ability to appropriate returns from its existing resources (Zahra et al., 2000). Observational learning is also often more efficient than experimental learning because it reduces the number of errors typical in experimentation (Bandura, 1977). Nevertheless, observational learning often fails in turbulent environments—such as transitional economies—because they require adaptation of newly gained understanding to new conditions which requires full comprehension (Huber, 1991; Van de Ven & Polley, 1992). Alliance partners may protect some know how from other alliance participants (Zahra et al., 2000), reducing the comprehensiveness of observational learning. In addition, tacit knowledge is difficult if at all possible to obtain via observation. Thus privatized firms cannot rely on imitation alone, but must also invest in experimental learning aimed at internal innovation (Kim, 1997; Zahra et al., 2000). Experimentation may be needed to develop new behaviors that are in concordance with existing cultural values, resources, and routines (Kogut & Zander, 1996, Kogut 1996).

Proposition 7 Privatized SOEs actively engaged in observational and experimental learning will perform better than those engaged in only one of these forms of learning.

The learning process has to engage the whole organization. For the firm to utilize acquired knowledge and decide what are its market opportunities, it needs to process the information gained from alliance partners, from scanning, or other means of data gathering (Huber, 1991). That is, an organization has to distribute information within the organization and interpret it, i.e. give it meaning (Daft & Weick, 1984). Organizations, just as individuals, however, interpret information based on prior knowledge or frame of reference (Cohen & Levinthal, 1990). Herein may lie a particular challenge for privatized firms in CEE because their frame of reference would be a fairly stable planned economy rather than turbulent markets.

The ability of the organization to absorb knowledge and to process information depends not only on managerial learning. It is a function of characteristics of the organization itself, notably it organizational forms and combinative capabilities (v.d. Bosch, Volberda and de Boer 1999). Research on Hungarian firms has shown that firms there improved their capacity to learn if organizational flexibility was promoted (Lyles & Salk, 1996). Organizations improved their ability to process acquired knowledge if collaboration and exchange of information within the organization is encouraged, employees were given greater latitude in altering activity patterns, and processes are adapted to perceived changing needs and conditions.

Proposition 8 Privatized SOEs' capacity to process acquired knowledge is positively related to fit and firm performance. A firm's capacity to process acquired knowledge increases with flexibility of its organization

The Resource of Management

The effectiveness of managers with experience only in former SOEs operating in planned economies in managing a market-oriented organization in transition is questionable. Inadequate managerial skills limit the dynamic development of resources at the privatized SOEs in CEE (Zahra et al., 2000). Effective management is salient for the capability of firms to develop new resources (Penrose, 1959; Teece et al., 1997). Integration of new and old resources to take advantage of market opportunities requires general management skills. However, while the technical skills of managers in CEE are considered quite high, general management skills are quite limited (Pearce, 1991; Puffer et al., 1994).

Managers in transition economies have to upgrade their qualifications far more fundamentally than is catered for by conventional management training. Consequently, Child (1993) and Villinger (1996) distinguish three levels of managerial learning necessary in CEE organisations. At the *technical* level, new and specific techniques have to be acquired such as methods for quality measurement, scientific and engineering techniques or the construction of samples for market research. At the *systemic* level, new systems and procedures have to be adopted, which requires an integrative type of learning emphasising co-ordination, relationships and links. At the *strategic* level, senior managers have to change their cognitive framework for doing business and conducting the tasks of management. They need to reassess their criteria of business success and factors contributing to that success, which requires an understanding of the technological and managerial processes in such depth that they can engage in innovation, select and adapt technology and take strategic decisions.

However, as argued by evolutionary and institutional economists, new practices have to be build on existing attitudes and value systems, preserving selectively what is worthy, and using experimentation to discover new best practices suitable for transition economies (Kogut 1996; Spicer et al. 2000). Vlachoutsicos and Lawrence (1996) argue that positive change in managerial practice will come about only if continuities with the values and decision-making processes of the Russian traditional collective are preserved, and the natural behaviour of Russian managers are integrated into newly-introduced managerial systems and practices.

While this research focuses on the individual level, our concern ultimately is with the combined strengths, i.e. the capabilities of the integrated management resources. We thus consider the joint rather than individual abilities of managers and build the following discussion on research on top management teams as an application of organizational learning theory. Related work there has identified that management teams are more able and willing to change the strategic orientation of a firm in a turbulent environment if managers are more heterogeneous, where heterogeneity refers to different educational background, age, industry experience, tenure, etc. of the top management team (Lant, Milliken & Batra, 1992; Wiersema & Bantel, 1992). Different experience and background may allow the firm to unlearn previous behaviors that are no longer functional and attempt different approaches to adapt the firm to new conditions. Managers that have longer tenure with the firm may be more able to preserve its traditional strengths because they are aware of them and their sources. Managers with a different background can introduce new approaches, recognize different relationships between the firm and its environment, and may generally be more open to change. Of course, a second requirement for propensity to change is that the members of the team interact and are involved in decision making (Thomas & McDaniel, 1990)

Considering the need for change at privatized firms in transitional economies and the daunting managerial tasks, we suggest that above findings also provide insights to the management of former SOEs. A heterogeneous, interactive management team can be expected to have higher absorptive capacity because of the broader experience it can draw on. In view of the need and challenges in managerial learning addressed above, heterogeneous top management teams may provide the better capability to develop, integrate and apply new knowledge and resources in new conditions while preserving traditional resources and values.

Proposition 9 *Management effectiveness is enhanced by the heterogeneity of the top management team, leading to deeper transformation of the privatized firm.*

Proposition 10 *Given heterogeneity of the top management team, management effectiveness is enhanced by the degree of participation and interaction within the management team, leading to deeper transformation of the privatized firm.*

IMPLICATIONS FOR FUTURE RESEARCH

Privatized firms in the transitional economies of CEE have initially adapted to new conditions mainly by downsizing. However, strategic restructuring, i.e., identifying new markets, developing new products or processes, etc., is rarely happening, except where SOEs were acquired by foreign investors (Ernst et al. 1996). The importance of the development of these organizations to the transformation of CEE economies, however, requires that these firms improve their efficiency and effectiveness. Fortunately, there is evidence that some firms have succeeded in this process despite adverse conditions.

Research so far has largely focused on analyzing human resource or governance issues. While these are of critical importance, the present work draws on two influential management theories to develop a model how these firms might learn to adapt their traditional resources to the new conditions. Organizational learning theory and the resource-based view here are integrated to develop a model and testable propositions for organizational transformation that focuses on specific firm-internal and external constraints of privatized SOEs in CEE. This perspective allows making specific problems in the transformation of former SOEs explicit, such as a limited absorptive capacity, and thus implies potential remedies.

This research is hoped to encourage further theoretical and empirical research. The propositions that we provided may be extended, for instance with respect to structures and systems of privatized firms in CEE as part of organizational transformation. As previous research has shown, organizational structure is an important determinant of firms' learning capacity (Lyles & Salk, 1996). Organizational structure also has to be adapted to achieve internal fit of the organization to optimize the returns to investments in new resources and capabilities. Further, research on human resource management might focus on organizational process issues regarding gatekeepers which may allow firms in CEE to more efficiently internalize new knowledge (Kogut & Zander, 1992). Future research may also identify which particular characteristics are essential in the composition of the top management team. For instance, acquirers of former SOEs have sometimes selected the general manager from within the new subsidiary because of his/her relationship to the employees, or replaced with an executive from the acquirer to allow for better communication with headquarters (McDonald, 1993).

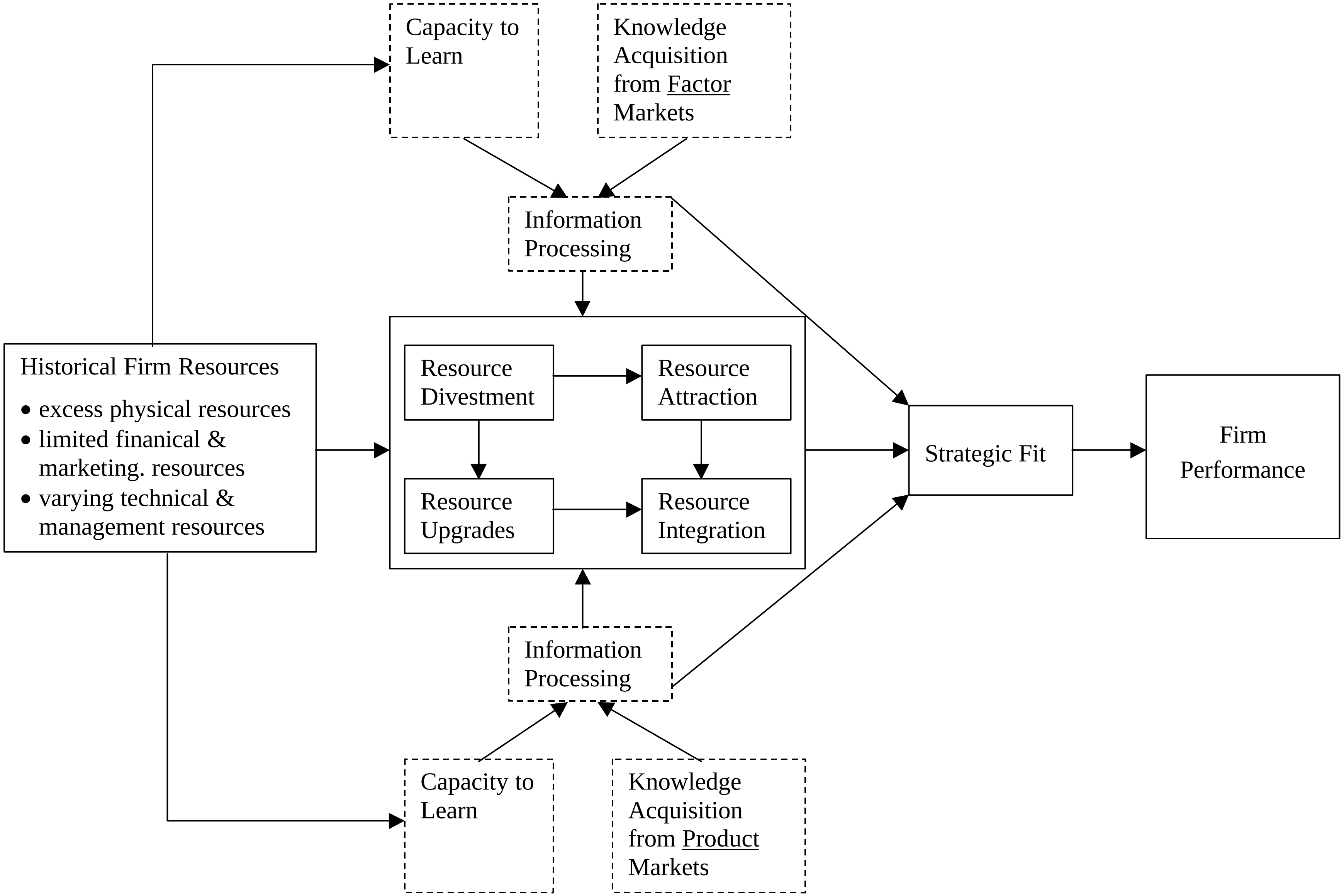
Empirical testing of the proposed model provides a further challenge. While sufficient measures have been developed to measure the constructs addressed here (see for instance Fiol and Lyles, 1985, and Huber, 1991, for measuring organizational learning), they typically have not been applied in transitional economies. This environment may suggest use of alternative variables. For instance, a traditional outcome variable in the strategic management literature is organizational growth (Ansoff, 1957; Peng & Heath, 1996; Penrose, 1959). However, privatized firms in CEE often have to get smaller before growth is possible. Also, survival may be more important than growth, particularly considering the overall decline of the transitional economies in CEE. Moreover, the model developed implies that divestment may be as important or even more so than efforts to grow the firm. We therefore suggest as the appropriate outcome variable for the model the firm's financial performance, such as profitability and productivity. Such measures indicate optimal use of resources (Peteraf, 1993). Research, such as that by Frydman et al. (1999) has shown ways how financial performance can be measured at firms in CEE.

While there are numerous examples for improved competitiveness and performance of privatized SOEs in transitional economies, there is also evidence for problems of firms doing so. In particular, it appears, that organizational learning and adaptation is moderated by the firms specific resources at the onset of transition in 1990 and its institutional embeddedness: for instance, a less-developed institutional system impedes development of privatized firms (Spicer et al., 2000). On the other hand, firms more embedded in the socialist central planning system face weaker external pressures (Newman, 2000, Suhomlinova 1999). Moreover, Peng (2000) suggests that larger privatized firms are particularly challenged in restructuring. These external conditions plausibly moderate the relationships we suggested, and need to be controlled for in an empirical analysis.

CONCLUSION

The recent recognition that the transformation of privatized firms in CEE to competitive organizations is progressing much slower than expected has spurned a shift in research from issues of governance to managerial issues. In particular, weak institutional systems, turbulent product markets, and underdeveloped factor markets have been recognized as firm-external barriers to organizational change. Internally, many firms are hindered by outdated product lines, inadequate assets, and management with little experience in competitive market environments. Based on current management theory, the present study provides some recommendations how managers of privatized firms may address some of these problems. In particular, we propose that firms improve their learning ability by actively searching for information in product and factor markets rather then relying on "grapevine" information provided by established networks. Also, there may be a need to adapt organizational structure and processes to allow for more efficient information processing. This should help firms in identifying sales opportunities and needed inputs to improve the resource of the firm. Nevertheless, these firms have a history and therefore built resource stocks in form of assets, know-how and organizational processes. Rather than outright disregarding these, there may be potential for further development of these resources (Spicer et al. 2000). Managers need to spend significant efforts on integrating resources so that firms are able to take advantage of recognized opportunities and thus achieve strategic fit. The proposed model provides the challenge to empirical research to identify the generality of important theories under extraordinary conditions.

Figure 1: A Model of Resource Development of Privatized Firms in Transitional Economies



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