Transformational Corporate Governance Changes in the Transition Economies: Antecedents and Implications for International Business Organizations

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Abstract

This article focuses on organizational or institutional transformational changes as the central and most consequential contextual aspects of transition economies moving away from centrally planned macro-economic policy to embracing an open market approach. In spite of the difficulties in carrying out changes due to internal resistance, change is seen by many as inevitable and mandatory. This article studied the drivers and consequences of organizational change, and the result of the literature studied shows that organizational changes in technical and administrative fields are differentially driven by firms' motivation to change related to their past performance, opportunity and internal capabilities to change, namely firm's ownership, managers' attitude and participative culture. While change definitely has direct positive impacts on firms' performance, its implementation should take a pragmatic approach to dampen resistance from within the organizations.

Keywords: **administrative change, organizational change, technical change, transition economies, transformational change, participative culture**

Transition economies, some call it "emerging economies", are economies in a state of transition moving away from the centrally controlled economies to embracing an open market reforms generally through programs like deregulation, privatization of state-owned firms and opening the country for foreign direct investments (Fahy, Hooley, Cox, Beracs, Fonfara and Snoj, 2000; Zahra, Ireland, Gutierrez and Hitt, 2000). Like the term "centrally planned economic" connotes, almost all of these centrally controlled economies have a State Agency for Economic Planning, like in the former USSR, North Korea, Cuba, Eastern Europe, Central Asia and the People's Republic of China (Muhlbacher, Leihs and Dahringer, 2006; Keegan and Green, 2005). These State Planners make 'top down' decisions about what goods and services are produced and in what quantities; consumers can then spend their money on what is available (Keegan and Green, 2005).

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Since not all 'transition economies' have economically emerged by undergoing impressive changes in their economies and, consequently, grow as vast markets, like e.g., Brazil, China and India (Cateora and Graham, 2003; Kotabe, Peloso, Gregory, Noble, Macarthur, Neal, Riege and Helsen, 2005) in term of Rostow's (1971) 'state of economic development' model, this article sticks to the more generic category of 'transition' rather than using the term 'emerging'.

Moreover, countries that are experiencing rapid economic expansion and industrialization are specifically commonly referred to as the 'Newly Industrialized Countries/NIC', like Singapore, South Korea and Taiwan, or the oil-driven 'emerging MENA countries' in the Middle East and North African regions, resulting in what Keegan (1989:7) termed as a 'semantic jungle of terminology'.

China, for example, started its quantum leap changes in the macro-economic policy in 1978 during the era of Deng Xiaoping, from a 'highly centrally planned economy' to a 'managed market economy', two years after the death of Mao Zedong, the Chinese conservative helmsman. With a clear vision ahead on its economic strategy and the turn around programming of its lackluster, inefficient and massively corrupt Chinese bureaucracy into a 'pro-business' and a relatively 'cleaner' civil service, PRC has been able to transform its economy receiving more than $50 billion foreign investment every year coming from more than 500 largest world-class corporations (Pepih Nugraha, 2006). Deng's famous words inciting social, political and economical transformation were: ***"Bu guan hei mao bai mao neng zhua dao laoshu jiu shi hao mao"*** ("It is irrelevant whether a cat is black or white as long as it can catch a mouse") (Rene L.Pattiradjawane, 2005)

In 2005, there were more than 250 million people classified as middle class in China, and the number is growing at the rate of 13 million per year. It is predicted that in 2020, China's middle class will number more than 500 million people (Kotabe et al, 2005), attributable to its market transformation success story.

China opened its door to foreign investments in 1979 (Beamish, 1993; Child, 1994) and today enjoying a yearly economic growth around 9-10% (Rene L.Pattiradjawane, 2005; Wiryawan, 2005). Under PRC's economic reform since 1979, massive institutional change has dismantled many barriers to modern business operations (Browne, 2006; Child, 1994). Institutional change in PRC is highly complex because in this formerly very closed, very state-dominated system, institutions had developed into a hugely massive inter-dependent, powerful multi-level network whose logic of operation in its governance depended much on political influence and personal relationship as on concern for efficiency (Nee, 1992).

Because of the delicate sensitivity of political and social considerations, PRC has followed a principle of 'pragmatism' with the aim of balancing the pace of reformative changes with social stability (Lin, 1998). This principle has enabled PRC to support fairly continuous economic reform without open conflict between the country's political factions. It has, however, created uncertainties for both international and local firms as to the exact speed and direction of the reform, as is also seen in Indonesia today, eight years after the fall of a very autocratic regime (Djisman S.Simanjuntak, 2006) in 1998 and the start of the so-called ***Reformasi***. Additionally, a series of the trade liberalization and market deregulation programs in Indonesia has in effect already started in about the same time with China, i.e in the early 1980s, but lacking in 'visioning, repositioning strategy and leadership' to follow the successful paths of China and India (Sri Hartati Samhadi, 2006).

To justify PRC's transition to a market economy, its leaders have creatively defined their goal as to develop a 'market system with socialistic characteristics'. This has meant that some sectors and regions have been more exposed to market competition and have changed faster than others (Dernberger, 1999; Luo, 2000). Nevertheless, by the early 1990s, most transactions in PRC were being enacted through markets (Naughton, 1994). They have moved increasing number of economic transactions from governance by personalized bureaucratic administration to impersonal contractual exchange (North, 1990)

The former USSR's Republics have also undergone unprecedented economic, political and social transformation since the demise of the USSR in 1989. Economic reform, deregulation, privatization and foreign direct investment have proceeded at varying rates throughout the region, dramatically altering the nature of competitive environment. There is evidence of increased levels of competition and of major changes in the nature of customer demand with significant advances in the sophistication of demand and intensity in competition in these countries (Cox and Hooley, 1995). Firms with a tradition and heritage of operating in a command economy were suddenly faced with the necessity to change by acquiring new skills, systems and governance to compete in a new market-driven environment.

One *outstanding* example of the former USSR Central Asia's Republics is Azerbaijan, a country with about 1.5 million people (material for this part has been taken from the "Supplement of Country Profile" in The Jakarta Post, May 26 2006, ***provided for*** by the Azerbaijani Embassy in Jakarta):

"Azerbaijan's current stage of independent evolution is largely based upon the secular and democratic ideals of the Azerbaijan Democratic Republic of 1918-1920, and is a logical follow-up to the latter. Fifteen years ago the country encountered a number of obstacles, including both problems common for the post-totalitarian states such as loss of traditional markets, disrupting of economic ties, galloping inflation, steadily growing unemployment, etc, and a number of region and country specific issues (internal political turmoil, separatist movements, territorial claim by a neighbour).

As a result of a wide-range of reforms conducted in recent years, improvement of legislation and adoption of effective measures of macro-economic regulation, substantial success was achieved in Azerbaijan in the dynamics of economic growth as well as in the creation of favourable conditions for the attraction of domestic and foreign investments. In 2005, Azerbaijan led the world in economic growth rate. The GDP was an unprecedented 27 percent, and industrial potential increased by over 33 percent. Average personal income increased 27 percent, salaries 22 percent. Inflation was 9.8 percent. In comparison with average personal income, real income increased 17 percent. The average monthly salary in Azerbaijan was $140 late last year. Per capita GDP was $1517. According to IMF forecast, 2006's GDP growth rate in Azerbaijan will reach 38.3 percent, thus demonstrating the highest GDP growth forecast among all IMF member-states".

Another transition economy successfully emerged as a robust world-class marketer is India. If PRC started its market liberalization during the Deng's premiership at the end of 1970s, India started its own economic transformation during the era of Manmohan Singh in 1991 when he, as the then-finance minister, dramatically purged several socialistic rigid economic systems and changed them with a more market-friendly approach, rendering India a yearly economic growth of about 8% (2003-2005) and becomes one of the largest world exporter today (Pepih Nugraha, 2006). India has also 300 million middle class people in 2005 to support its emerging market position (Kotabe et al, 2005)

As a comparison, Indonesia's economic growth is still below expectation with Gross Domestic Products/GDP growth slowed to 4.6% on-year in the first quarter of 2006 (Endy M.Bayumi, 2006), with still a declining trend (Djisman S.Simanjuntak, 2006). Earlier, the International Monetary Fund/IMF had predicted Indonesia's growth in the 5% range for all 2006, only about half of the growth in PRC or India as examples of successful 'transition economies' transforming themselves into 'emerging markets'. Extant literature in international business on economic reforms in transition economies have by-and-large focused on PRC, India, Eastern Europe and Central Asian countries, with lesser attention to other transition economies; hence literature on Indonesia in the international business is also very scarce.

In the general term of management theories, in order to uphold and maximize efficiency, institutions ought to develop

and govern their activities following standardized systems and organizational rules (D'Aunno, Succi and Alexander, 2000; Pearce and Robinson, 2003), to create and sustain competitive advantages (Dess, Lumpkin and Taylor, 2004). Institutions are social, economic and political bodies that articulate and maintain widely observed norms and rules in their governance (North, 1990; Scott, 1995). Any change in their governance may disrupt these routines and can be further seen as a threat to the establishments, making change very difficult because of the strong internal resistance as posited by Hannan and Freeman (1984) and by Granovetter (1985). Several other studies (Amburgey, Kelly and Barnett, 1993; Greenwood and Hinings, 1996; Greve, 1998; Miller and Chen, 1994; Rhenald Kasali, 2006) have all argued that organizations strongly resist change in most cases.

At the other end, however, Kanter, Stein and Jick (1992) and Kanter (1995) stated specifically that the third millennial label and transformational implications suggest the possibility of an equally profound change in the economic life and organizations, primarily business firms. Since today's (business) environment is increasingly more volatile and riskier than ever, there is an imminent danger looming if and when organizations do not know how to adapt and change in time (Brown and Eisenhardt, 1997; Feldman, 2004; Piderit, 2000; Rhenald Kasali, 2006). The challenge is even more extreme in transition economies undergoing unprecedented changes in almost all fields like legal, social, culture and economic institutions in their quest for adaptation to the newly reformed environments. As Hoskisson, Eden, Lau and Wright (2000) posited, organizations in transition economies are facing strong environmental pressures for change, but these changes are neither smooth, automatic, nor uniform across markets.

Since change is inevitable (Kanter, 1995; Kanter *et al*, 1992; Rhenald Kasali, 2006) while organizations strongly resist change, it is therefore necessary to learn what facilitates and what inhibits organizational change, in particular in transition economies. Extant organizational change theory, however, provides only limited insights into these questions. Until recently, organizational change studies in transition economies (see e.g,: Boisot and Child, 1996; Peng and Heath, 1996.; and cfr: Wiryawan, 2005) have focused more on state-level policies effected by liberalization and privatization with firm-level strategy relatively untouched.

CONCEPTUAL FRAMEWORK OF ORGANIZATIONAL CHANGE

Kanter et al (1992) stipulated that when people discuss "organizational change" they create more heat than light as a common experience, since certain words and phrases are full of ambiguity. It is at once a source of strengths and also of weaknesses. Even philosophers have been for centuries struggling with the concept and definition of 'change' though obviously not in the connection with business organizations. One example is Heraclitus (circa 504-501 BC; some, like *The American College Dictionary*, 1961: 565, claim that he was born in c.a 535-475 BC), an Ephesian nobleman dubbed the 'wheeping philosopher', is known to many for the famous saying that "All things are in a state of flux" (Coplestone, 1985:39). Heraclitus does indeed teach that Reality is constantly changing *(Panta Rei)*, that it is its essential nature to change.

But Heraclitus was emphatically not thinking of a deliberate change. Any idea of a deliberate and transforming change tampering with the basic character of things then was blasphemy to the ancient Greeks to say the least; if not a sure path to disaster which was fundamental to the Greeks' great tragic drama (Kanter *et al* ,1992).

The American social psychologist Kurt Lewin (1890-1947) was a pioneer of the systematic study of planned and deliberate change in the mid 1940s. His model was a simple one, with organizational change involving three stages: unfreezing, changing and refreezing (Jones, 1968; Oja and Mulyan, 1989; Rhenald Kasali, 2006). Lewin was also famous for being the originator of the 'action research method' marrying theory and practice by stressing that all general plans should be flexible, not frozen (Abraham, 1994). Deliberate change is, therefore, a matter of grabbing hold of some aspects of the motion and steering it in a particular direction that will be perceived by key players as a new method of operating or as reason to reorient one's relationship and responsibility to the organization itself, while creating conditions that facilitate and assist that reorientation (Kanter et al, 1992)

This change occurs in a variety of forms: new technology and procedures, new products, new clients, new systems, new process, or anything else new to the organization (Bergquist, 1993; Brown and Eisenhardt, 1997; Haveman, 1992; Rajagopalan and Spreitzer, 1996). More recently, theorists (see: Brown and Eisenhardt, 1997; Feldman, 2004, Tsoukas and Chia, 2002; Rhenald Kasali, 2006, and indirectly also: Wiryawan, 2005) have argued that a continuous and evolving view of organizations is a more fitting description of the change phenomenon, given the highly uncertain and volatile markets like in the transition economies in particular.

Furthermore, change necessity is not limited to the private sectors. Government agencies and public servants need to undertake reforms so comprehensively and lay the groundwork to improve government performance, though the profound differences in their purposes, their cultures, and the context within which the public sector operates conjure up quite different obstacles than the private sector (Ostroff, 2006). The greatest challenge in bringing about successful change and significant, sustained performance improvement in the public sphere is not so much identifying solutions, which are mostly straightforward, as working around some unique obstacles says Ostroff (2006)

Substantial attention must be devoted to prescribing adaptation as a component of change phenomena. For example, it is often argued that consumer products, advertising campaign, distribution policies — and first and foremost the service industries like hospitals, schools/higher learning education — are more likely to function more effectively when they are modified, or changed, to reflect local market dynamics. Existing normative advice focuses on isolating criteria that should guide such adaptation as a change component, with criteria including differences in culture (Lemak and Arunthanes, 1997), consumer preferences and needs (Cui and Liu, 2001) and labor practices (Rosenzweig and Nohria, 1994)

Other theorists conceptualize a firm's learning capability as a major source of its adaptability to change phenomenon, such as how organizational learning impacts a firm's change capability in a multinational expansion (Barkema, Bell and Pennings, 1996; Benito and Gripsrud, 1995; Chang, 1995; Makino and Dellios, 1996), diversification decisions (Pennings, Barkema and Douma, 1994), innovation (Cohen and Levinthal, 1990; Rhenald Kasali, 2006; Peters, in Grayson, 2006), and international joint venture survival (Barkema and Vermeulen, 1997; Barkema, Shenkar, Vermeulen and Bell, 1997). These theorists have by-and-large supported the central tenet of the organizational learning perspective in that learning enhances capability to (1) learn, and (2) absorb changes adapted to the environmental needs since change does not take place in a vacuum, but rather has "to cope with confusing experience" in specific environments (Levinthal and March, 1993:95).

Business expansion into transition economies mentioned above like Brazil, China, India, Indonesia, or the former USSR, which are characterized by a tremendous amount of environmental turbulences, is perhaps more difficult and necessitates greater efforts in organizational learning (Luo, 1997; Luo and Peng, 1998; Peng, 2000). Within each of these countries, unfamiliar organizational forms and inconsistent regulations have often forced firms to operate in a different corporate systems and regulations as mandated by these environments.

Transaction and agency costs are also known to be high in transition economies while resource availability is limited (Hoskisson *et al*, 2000). Institutional changes, if adopted, are expected to reduce these transaction and agency costs in a number of ways. The development of efficient markets, with more transparent rules of the game, reduces transaction and information costs, while the institutional specifications and enforcement of property rights also reduce transaction costs. The strengthening of property rights reduces the risks of unauthorized appropriation, and, hence, the costs of monitoring the use of technology, enhancing the range of technology that foreign organizations are willing to provide, especially the introduction of advanced technology which itself is an engine for improvements in the efficiency of the organizations.

Many firms in transition economies also face ecologies that provide neither specialized resources and institutional supports nor good general-purpose financial, educational, political or legal infrastructure (George and Prabhu, 2000; Khanna and Palepu, 1997). In these transition economies, firms may play a vital role in addressing basic social needs like clean water, new farming techniques, jobs, but are burdened by lack of environment generous budget (Carney, 1998).

The rapidly changing dynamics of transition economies may provide an environment necessitating changes, where the only thing constant is 'change' and firms must accept the facts that they need to continuously reinvent themselves (March, 1991; Hoskisson et al, 2000; Rhenald Kasali, 2006; Slater and Narver, 1995; Tsoukas and Chia, 2002)

THE CORPORATE GOVERNANCE AS SYSTEM

Corporate governance and governance institutions are by-and-large concerned with the means by which a firm's stakeholders control the decisions made by corporate senior management. Any stakeholder can try to use market exit and/or voice to influence firm's decision, as stated by Noteboom (1999)

Corporate governance operates differently in two broadly distinct categories. In an Anglo-American context the governance criterion is narrower, and is usually restricted to shareholders, inclusive outside investors (mainly lenders), trying to ensure that they are not exploited by opportunistic senior managers within the firm (Shleifer and Vishny, 1997). The monitoring of the management performance relies mainly upon market-based rewards and penalties, where labor and capital employed by the firm exhibit low levels of commitment.

Capital is often withdrawn from one firm for higher expected returns elsewhere, and the impact of this withdrawal on stock prices may penalize and reward managers through what is called by Dore (2000) as 'market capitalism'. Here, stock price reductions encourage hostile takeover threatening the service of weakly committed executives. Conversely, high stock prices raise their pay. This variety of capitalism (Hall and Soskice, 2001) depends on high levels of information disclosure to outsiders to inform investment decisions and the laws that protect minority shareholders (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 2000).

These individual elements mutually support each other in a governance system, and radical attempts to change one element may be frustrated by a lack of corresponding change elsewhere (Hall and Soskice, 2001; Rhenald Kasali, 2006). Indeed, one variant of the literature of governance systems sees global convergence on stock market capitalism as a clear possibility (Coffee, 1999). Meanwhile, any convergence could conceivably be on some governance hybrid or even divergence as change manifestation could prevail (Mishaupt, 1998).

In a second category of corporate governance, however, beyond the Anglo-American context, corporate governance usually refers to the means by which any of the firm's stakeholders (not just shareholders or lenders) may control executives' decisions. These stakeholders are highly committed to the firm and are prepared to contribute formally to its governance (Hall and Soskice, 2001). The transition economies generally adopt this governance system. Business expansion into transition economies such as China, India, Brazil, Eastern and Central Europe, and Indonesia, which are characterized by tremendous amount of turbulence, is perhaps more affected by these stakeholders' governance system necessitating greater efforts in both organizational learning and governance change (Luo, 1997; Luo and Peng, 1998; Peng, 2000; Wiryawan, 2005).

Within each of these countries, fragmented markets, unfamiliar organization forms, and inconsistent regulations have often forced firms to learn how to operate and adapt to different local markets (Boisot and Child, 1996; Peng and Heath, 1996). Using a meta-analysis of the 'contingency theory' literature on the PRC's textile industry study, Wiryawan (2005), concluded that in a transition economy with turbulent

environmental dynamics like in China, a firm's performance is greatly enhanced when top management is adaptable to changes as innovations in corporate governance are dictated by these environmental dynamics.

In Indonesia, for example, only small percentages of the total stock of large firms are in free float, trading volumes are relatively low, and information disclosure for outsiders is still quite weak (Kanto Santoso, 2003). Insiders such as employees, bank shareholders, and inter-locking shareholders are, however, well informed. It is their influence through a two-tier board system that control the behavior of the executives (Conyon and Schwalbach, 1999) since these stakeholders are often represented on supervisory boards or in the work council in the case of employees. They also function as opinion feeders to the boards. Rhenald Kasali (2006) stressed that full commitment from these stakeholders is a prerequisite for any organization in attempting changes.

Within these two distinctive categories of corporate governance, can the system in one country change to take advantage of, be learned from, adopt, innovate, developed in the other country? Alternatively, are such innovations rejected totally or subject to a significant degree of customization? To address these related questions, this article attempts to suggest fresh implications on firm level governance changes.

THE DIRIVERS OF CORPORATE GOVERNANCE CHANGE

Basing on previous works, the factors that drive firms to change are 'technical organizational changes' (Brown and Duguid, 1991; Damanpour, 1991); 'administrative organizational changes' (Tsoukas, 1996), and 'national cultures' (Hofstede, 2002; McSweeney, 2002; Williamson, 2002). Technical organizational changes pertain to products, services and production technology. In contrast, administrative organizational changes involve organizational structure and administrative process like the way of recruiting and training personnel. National culture is seen as a collective programming of the mind, where a national culture value is likely to be embedded in the country's educational institutions.

From the point of contingency theory (which emphasizes the 'fit' between environmental contingencies and internal organization), Wiryawan (2005) argued that though top management is implied as being essentially reactive, it is also plausible that they can take the initiative to leverage capabilities to adapt to changes in such a way that the firms are able to co-evolve alongside the environment. Firms can therefore positively impact their performance.

Since organizational change is seen in general as a risky decision, managers ought to have legitimate reasons and compelling incentives to break their existing routines by 'changing the rule of the game' as stated by Rhenald Kasali (2006:11). Using the 'sigmoid curve', Rhenald Kasali (2006) cited several Indonesian firms as examples of local corporations that have lived their good and their bad years, the 'ups' and 'downs' throughout their corporate history (or past performance) necessitating to perform all kinds of efforts in managing the survival of the firms. The driving forces behind the changing rule of the game need strong reinforcement against the resistances if firms will succeed. Past performance is, therefore, one such motivator.

Existing literature, anyhow, have provided inconsistent predictions regarding the relationship between past performance and corporate governance change. Some scholars (Greve, 1998; Miller and Chen, 1994; Rhenald Kasali, 2006; Tushman and Romanelli, 1985; Wiryawan, 2005) suggest that poor performance in the past widens the gap between managerial aspirations and achievements, thereby providing a strong incentive for firms to look for new ways to improve. Damanpour (1991) argued that past performance has only vague implications for future performance in administrative changes such as reforming the personnel management system and in restructuring business operation system. Some others (Brown and Eisenhardt, 1997; Feldman, 2004; Tsoukas and Chia, 2002) argued that even good performance continuously motivates firms to change, especially in uncertain environment. Because good performance reinforces managers' confidence in their internal operations and systems, they tend to focus more on improving product and technological areas to secure future success. Many successful firms have, therefore, undertaken constant, rapid changes, particularly in their new product development, before something bad occurs due to strenuous competition.

Change, therefore, may comprise continuous systemic, regulatory governance changes (Rhenald Kasali, 2006), perhaps imposing on firms changes borrowed from other governance systems, as well as the spontaneous, imitative diffusion at a firm level of specific governance innovations originating in another systems as a learning process. Innovation diffusion theory (see, e.g: Rogers, 1995) has traditionally been the dominant innovation theory, typically addressing those factors that influence an innovation's speed and diffusion. It also concerns to some extent with the 're-invention' of innovation, meaning the degree to which an innovation is changed or modified by a user in the process of adoption and implementation.

Related to the attributes of individual firm's governance elements, it is therefore useful to consider theories of 'innovation translation' as proposed by Law (1992) and by Czarniawska and Joerges (1996) who identified cooption as the process by which social systems absorb changes, which is, they defuse, dilute and turn to their own ends the energies originally directed toward change. This theory was developed in the context of innovations in applied science, and provides an intermediate position between technological determinism and social reductionism. Both can never be separated in a clean way as there can never be purely technical or purely social factors being arranged in a heterogeneous network (Biggart and Guillen, 1999; Law, 1992; McLean and Hassard, 2004). Moreover, the adoption of an innovation through a learning process leading to change in the governance depends upon the power, belief and commitment of the executives (Rhenald Kasali, 2006).

A permanent struggle between interest groups is envisaged, with the outcome (change, which is) depending on the power of the interest groups to establish and

monitor points of passage to manipulate proposed innovations to suit their interests. The apparent change or innovation may be a shrewd camouflage concealing its embedded-ness in antecedent culture, institutions and knowledge structures influencing cognition (Zeitz, Mittal and McAulay, 1999)

Firms can be aware of alternative ways of doing business through two sources. Firstly, the market environment in which firms locate offers vivid examples of how various competitors operate and perform, providing firms the opportunities for organizational changes in a learning process (Greve, 1998; Miller and Chen, 1994). More specifically, Huber (1991:89) noted that 'an organization learns if any of its units acquires knowledge that it recognizes as potentially useful to the organization'. Of particular importance is Mach's (1991) distinction between 'exploration' and 'exploitation' in organization learning leading to organizational change. Exploration includes 'things captured by terms such as search, variation, risk taking, experimentation, play, flexibility, discovery and innovation', whereas exploitation includes 'such things as refinement, choice, production, efficiency, selection, implementation, and execution' (March, 1991:71).

While both kinds are important in rendering changes, there is a trade-off between the two, since 'exploration of new alternatives reduces the speed with which skills at existing ones are removed' (March, 1991:72). Since knowledge incorporates implicit and tacit dimensions along with those which are explicit and codifiable (Kogut and Zander, 1992), organizations must see change as an open window permitting them to gain more tacit knowledge.

Second, organizations, especially business firms, can actively identify new alternatives by monitoring customers and competitors closely through a market orientation (Day, 1994; Jaworski and Kohli, 1993; Slater and Narver, 1995). In most transition economies like in the PRC as example, institutional reform has been non-linear and has displayed a mixture of progress and regress because of its sensitivity to political and social considerations (Nee, 1992; Park and Luo, 2001). Subsequently, out of consciously experimental reforms, different governance systems have emerged in different areas (Boisot and Child, 1996; Kanter *et al*, 1992). Areas designated as reform zones have been the most affected. Inconsistencies in the reform agenda give rise to wide variations in the economic development, business atmosphere, and government policies across different areas (Lau, Tse and Zhou, 2002); as is seen in most, if not all, transition economies including Indonesia.

Accumulating knowledge on the reformative pitfalls in transition economies help firms overcome their initial concerns while reducing operational uncertainties and enhancing performance (Makino and Delios, 1996; Shaver, Mitchell and Yeung, 1997). In other words, due to 'time compression diseconomies' (Dierickx and Cool, 1989), firms that have spent time in transition economies may acquire a significant competitive advantage compared to firms that are not in that economy (Shaver *et al*, 1997). In general term, the longer firms operate in a specific transition economy, the more capability they tend to develop (Chang, 1995; Makino and Delios, 1996). As a result, intrinsic disadvantages due to inexperiences or foreigness can be substantially overcome through their adaptability and willingness to change in their governance (Zaheer, 1995).

Firms with a greater length of local presence in the transition economies are also likely to have a superior position in selecting market segments, differentiating product offering, accessing promotion channels, and building up corporate and product image as concluded by Wiryawan (2005) in his study on the 'Hongdou' apparel industry experience in the PRC. This length is also positively related to cooperation with partner firms (Barkema and Vermeulen, 1997; Wiryawan, 2005). Moreover, a long established presence in a transition economy such like China often results in a favourable image perceived by local customers, suppliers, competitors and governments (Child, 1994), well-established marketing and distribution networks (Shenkar, 1990), familiarity with culture-specific business practices (Luo, 1997), and greater ability to reduce operational uncertainties and financial risks (Luo, 1998).

The relationship between organizational learning, change capability and economic performance may be moderated by the organizational environment in the transition economies (Rosenzweig and Singh, 1991). Firms clearly need to pay attention to environmental forces as McCarthy, Puffer and Simmonds (1993) found out that firms often seem to be on a 'roller coaster' in these economies. Given that the institutional, economic and socio-cultural environment environments are dramatically different from those in the developed economies (Peng and Heath, 1996), it can be deduced that environmental uncertainties can easily render prior learning gained in these developed economies ineffective in such a dynamic new setting (Murtha and Lenway, 1994; Pearson, 1991). Organizational learning is, therefore, a multidimensional construct imposing severe constraints on the firms' ability to perform effective and efficient governance of the firms, which, subsequently, influences organizational performance (Pfeffer and Salancik, 1978).

While a number of conceptual dimensions of organizational environment have been proposed (see, e.g.: Aldrich, 1979), empirical research has converged on a parsimonious set of three key dimensions (Keats and Hitt, 1988), namely (1) hostility (i.e., importance and deterrence of environmental factors); (2) dynamism (i.e., predictability and variability of environmental factors); and (3) complexity (i.e., diversity and heterogeneity of environmental factors). In the transition economies, these factors not only involve economic players like competitors, customers, and suppliers, but also institutional and socio-cultural segments (Dickson, 1992; Peng, 1999; Shenkar and von Glinow, 1994; Tan and Litschert, 1994)

Tan and Litschert (1994) suggested that the environment in a transition economy, characterized by a weak regulatory regime, underdeveloped factor markets, and poorly protected property rights, is typically hostile. In such an environment, a firm's experience may become more valuable if it can turn its governance through a change within its system to

adapt to this hostile environment. Shan (1991), Luo (1998) and Wiryawan (2005) have all suggested that experience in dealing with more environmental dynamism increases the firm's ability to scan the external environment, analyze changes, and seize opportunities. In short, in a fast-changing, dynamic context, experience gained in such an environment is likely to contribute more to the growth and survival of the firm.

Dickson (1992) noted that heterogeneity in resource supply and production demand in transition economies is a vicious circle with no clear beginnings or ends as firms respond to changing demand by experimenting with new ways of serving customers. Consequently, ongoing resource decisions place firms on a path trajectory which may be positive or negative relative to environment movements and even firms with the best products may lose out in the marketplace because they have locked into the old paradigm.

The diversity of the market exposes firms to a variety of new ideas and process, which enable them to initiate changes (Miller and Chen, 1994). Moreover, in a highly competitive environment firms learn more about the operations of their competitors and the demand of the market. This helps firms generate insights about taking new actions such as cutting-edge technologies and modern administrative systems to keep up with competition (Day, 1994). In contrast, in less developed areas the legacies of the country's planned economy are evident: competition is minimal, government intervention is strong, and resources are scarce (Boisot and Child, 1996). Even if they have strong motivations to pursue new opportunities, their limited exposure to new information sources constraints their ability to find new ways to initiate changes, and forces them to rely on special (and usually collusive and corruptive) connections to compensate for such constraints and disadvantages (Park and Luo, 2001)

A critical strategy of the reform in transition economies (and also in Indonesia) is the privatization drive for its state-owned enterprises/SOEs (Hoskisson *et al*, 2000; Park and Luo, 2001; Wiryawan and Wiryawan, 2003). In the past, these SOEs operated according to the input and output quotas mandated by the government, which accustomed them to executing rather than planning and deciding future direction of the enterprises. Currently, SOEs have attempted and been encouraged by the government to undertake transformation into market-based firms to survive intensified competition.

This attempt, however, has been hampered by the entrenched routines and historical influence of the planned system (Boisot and Child, 1996). Peng and Heath (1996) argued that most of these SOEs executives are selected not on the basis of their technical expertise or managerial capabilities, but rather according to their ability to follow executive orders and political connection. Their inability to master modern technology and managerial efficiency greatly hinders the organization's capability to change (Rhenald Kasali, 2006). In contrast, non-SOEs were born as market-based firms, so their managers tend to develop a strong sense of market competition and take quick actions to respond to market changes.

Furthermore, the privatization of former SOEs has taken many forms with differing levels of effectiveness in each transition economy. Consequently, a variety of ownership types can be found. Four main categories generally developed, namely SOEs (firms that have remained state-owned), privatized SOEs (firms that have been privatized through domestic investment), FDI firms (firms in full or part foreign ownership) and organic firms (private firms that have never been state-owned). The FDI group was subdivided into three further sub-groups, namely joint ventures with former SOEs, joint ventures with private firms and finally 'Greenfield' investments being wholly-owned start-up operations by foreign firms that did not involve any merger, acquisition or alliance activity with domestic entities (Kotabe et al, 2005).

Privatization of SOEs, i.e., the transfer of firm ownership from governments to private investors (Vickers and Yarrow, 1988), has become an important tool of economic policy starting in the United Kingdom in the early 1980s and then progressing to other developed and less-developed countries including the former socialist countries now referred to as transition economies (Nankani, 1990). While for free market economies, privatization is largely a philosophical issue, for the less-developed countries and the transition economies it also involves development imperatives (Vernon, 1988).

Most research on privatization has been essentially evaluative and has focused on the societal benefits of privatization (Donahue, 1989; Ramamurti, 1992). The economic literatures have discussed methods for privatizing like the voucher system and liquidation (Frydman and Rapaczynksi, 1992; Vickers and Yarrow, 1988). Management research has added to work in economics in attempting to determine the outcomes of privatization (Goodman and Loveman, 1991; Parker and Hartley, 1991).

Pro-privatization arguments suggest not only that reductions in government ownership should improve a country's economy, but also that competitive environments and capital market discipline increase the efficiency of privatized SOEs (Aharoni, 1986; Goodman and Loveman, 1991; Perry and Rainey, 1988). Empirical research on this point and on the question of the most effective methods of privatizing has yielded conflicting results (see: Cook and Kirkpatrick, 1988; Hutchinson, 1991; Parker and Hartley, 1991; Targetti, 1992; Rondinelli, 1994).

De Castro and Uhlenbruck (1993) stated that the reasons for these discrepancies might include (1) an over reliance on anecdotal data as the basis for policy and recommendations, (2) a lack of rigorous theoretical and cross-disciplinary approaches, and (3) an emphasis on public policy outcomes of privatization, to the neglect of firm-level variables, such as deal terms stipulated by the selling government or the fit between the privatized firm and its acquirer. The result is a lack of specific guidelines for shaping deal conditions given the characteristics of the firm and the country, which may often lead to strong domestic protests from the anti-privatization camp (Wiryawan and Wiryawan, 2003). Although most of the published work expressed pro-privatization sentiments, no clear conclusions can be drawn about the

nature of effective privatization process.

The study of Child and Tse (2001) suggested that shared-stock ownership (a new form of firm) is more effective in motivating firms to perform efficiently and effectively. In a transitional economy, where workers are used to sharing the 'iron rice bowl', this new ownership form may encourage them to rethink their work ethics and enhance their inputs. Perhaps, that way the free rider effect and spending spree of firm resources can be reduced.

One difficult challenge in reforming the country's economy in a transition economy is the reengineering of the SOEs. Most SOEs are known for their inefficiency and lack of concern for profitability. Under the old planned economy, SOEs survived and grew through managing their socio-political networks in a manipulated economic system (Peng, 2000). From being the 'privileged few' these SOEs are now fast becoming the 'defeated masses' (Li and Tan, 1997)

For any business, SOEs and non-SOEs, one critical capability of change lies in the characteristic of the leadership, because change essentially requires leaders to create new system and institutionalize new approaches (Kotter, 1995; Nadler and Tushman, 1990; Rhenald Kasali, 2006; Wiryawan, 2005). Major changes are impossible if the leaders of an organization possess unfavourable attitudes, as they constitute one of the most important sources of political resistance (Goodstein and Boeker, 1991; Hannan and Freeman, 1984; Ostroff, 2006; Rhenald Kasali, 2006). The leaders' favourable change attitude also facilitates an organizational climate that encourages changes, disrupts existing bases of power, and overcomes internal political constraints. In the implementation phases, leaders' favourable change attitude is especially needed to create the interdepartmental coordination and conflict resolution ensuring the success of the change (Damanpour, 1991), especially when related to assets sales in the privatization.

There are quite differences among developed, less-developed and former socialist countries in the post-privatization requirements imposed on acquirers. Post-privatization requirements may limit the acquirer's ability to integrate and renew the target organization, with significant implications for performance (Donahue, 1989). Post-privatization requirements constitute one of the most consequential differences between the acquisition of and SOE and typical merger and acquisition deals (De Castro and Uhlenbruck, 1993) Prahalad and Doz (1987) argued that host governments can increase pressures on the acquiring firm to respond to local conditions through trade policies, laws requiring that supplies be purchased locally, tax policies, exchange controls and price control.

The work of Lenway and Murtha (1994) and Murtha and Lenway (1994) suggested that there might be significant differences among developed, less-developed and former socialist countries with respect to post-privatization conditions. Since they are likely to have established markets, be characterized by relatively high individualism, and to emphasize decision-making based on economic concerns and efficiency, governments in developed countries should stipulate fewer post-privatization requirements.

Less-developed countries tend to combine more authoritative planning with private property (Murtha and Lenway, 1994), and their political process emphasizes nationalism and a need to maintain political coalitions (Wiryawan and Wiryawan, 2003). Those conditions would bespeak of a need to protect workers from layoffs and clear conditions on investments that would indicate to the general public that assets are not being easily given away to acquirers. These facts suggest that less-developed countries are more likely to impose post-privatization requirements than former socialist countries, as is seen today of the government of Indonesia's policy on the sale of Semen Gresik shares (privatization) to CEMEX S.A of Mexico (*TEMPO*, May 28 2006, p 80-81)

The implementation of organizational change (ownership, systems, technology) is difficult because it may disrupt the existing stable work routines and requires that members of the firm learn new patterns of communication flow, integrate new members to fill new job functions, and establish new work routines to manage the altered work flow (Haveman, 1992). The success of organizational changes needs universal acceptance and the support of employees at different ranks in the firm, suggesting the importance of a participative culture in implementing changes (Rhenald Kasali, 2006).

This participative culture emphasizes the importance of unity, cooperation, and belonging among employees, promotes employees' understanding of both the firm and the market, and encouraging their participation in decision-making (Quinn, 1988). In other words, a participative culture positively moderates the relationship between organizational change and firm performance. As economies that were formerly centrally planned move towards open markets, the institutions that were woven into the cultural and ideological fabric of the country do not suddenly disappear (Lau *et al*, 2003). Rather, these intricate economic, social and political systems, with long-established goals and rules, continue to shape the distinctive institutional cultural milieu within which firms need to work in these transition economies (Peng, 2000).

Similar postulates can be found in the emerging strategic leadership (Boal and Hooijberg, 2001) in which leaders' capacities to learn, change and manage are core attributes, especially in a country like China where collective interpersonal cultural orientation, leaders' ability to navigate through socially complex institutions is critical to their success. They are able to articulate changes that give recognition to the firms past and at the same time move its operation into the future effectively (Gioia and Thomas, 1996). This is often regarded as the social intelligence that leaders need to possess so as to win the confidence of their followers since respect for corporate leaders becomes especially more relevant during continuous and overlapping reforms (Hui, Law and Chen, 1999; Child and Tse, 2001).

In order to fully understand the business environment of a national culture, it is best to consider important within-culture differences (Schneider and Barsoux, 1997) in a newly reformed market like China. National culture is defined as the values, beliefs and assumptions learned in early childhood that distinguish one group of people from another (Beck and Moore, 1985; Hofstede, 1991). This

definition is consistent with Hofstede's (1991) notion of national culture and also with Jaeger's (1986) common theories of behaviour or mental programs that are shared. National culture is embedded deeply in everyday life and is relatively impervious to change, especially in a 'high-context' society (Hall, 1979) of the Confucian societies like China where this Confucian culture has been embedded for many thousands of years.

National culture is a central organizing principle of employees' understanding of work, their approach to it, and the way in which they expect to be treated. National culture implies that one way of acting or one set of outcomes is preferable to another. When management practices are inconsistent with these deeply held values, employees are likely to feel dissatisfied, distracted, uncomfortable, and uncommitted. As a result, they may be less able or willing to perform well. Management practices that reinforce national culture values are more likely to yield predictable behaviour (Wright and Mischel, 1987), self-efficacy and high performance (Earley, 1994) because congruent management practices are consistent with existing behavioural expectations and routines that transcend the workplace. Employees are not distracted from work performance by management practices that ask them to behave in ways that are consistent with extant national cultural values.

Never-the-less, very few countries in recent history have experienced the number and magnitude of societal changes that have occurred in China since the Qing Dynasty. Many of these changes were deliberately designed to radically reshape beliefs and attitudes which logically may have had marked influence on the cultural values of the Chinese workforce and, in particular, its executives.

The Republican Era (1911-1948) followed the Qing Dynasty. During that era, Confucianism flourished and a Western presence was prominent in the commercial areas such as Shanghai. The People's Republic Consolidation Era (1949-1965) which followed was epitomized by violent purges against the educated, and an attempt to supplant Confucian ideals with Maoist doctrine. During that period, anything Western was denigrated. The subsequent Great Cultural Revolution Era (1966-1976) only served to intensify the attacks initiated during the Consolidation Era earlier. The Social Reform Era (1977-present), initiated by Deng, saw a movement back to the acceptance of Confucian cultural values and commerce with the West, including some acceptance of the influence that would usually attached with this global commerce (James, 1989; Laaksonen, 1988; Lin, 1995)

To understand the essence of the cultural evolution from the previous two periods under Helmsman Mao's "work for the good of society" philosophy can be captured by Deng's acknowledgment that 'a few flies' (or Western culture) would likely come through the open door economic policy, in the new and pragmatic 'to be rich is glorious' plan to modernize China by the early twenty-first century.

THE IMPACTS OF TRANSITION ECONOMIES INSTITUTIONAL CHANGE ON BUSINESS ORGANIZATIONS: SOME PROPOSITIONS

Hannan and Freeman (1984) suggested that, because organizational change disrupts the internal routines and external linkages of an organization, it may be detrimental to firm performance. More recent works, however, suggest that the impact of organizational change on performance may depend on the environment (Brown and Eisenhardt, 1997; Haveman, 1992; Rhenald Kasali, 2006; Tsoukas and Chia, 2002; Wiryawan, 2005). It is anticipated too that both technical and administrative changes are beneficial to firm performance in transition economies.

The following propositions capture the implications of institutional changes for firms' governance and strategies in the transition economies. These propositions also serve to identify issues for further investigation by interested researchers in the international business.

P1: The change from centrally planned to market economies increases the transition economies' attractiveness as an environment for international business.

Both upstream and downstream markets in transition economies have been transformed to become more efficient, which can reduce firms' information and transaction costs. In addition, the development of market-friendly governance improves resource allocation and ability as well. The change to an open market economy permits international firms to operate within a relatively familiar framework of rules rather than one in which special deals have to be made with government officials who knows almost nothing about business firms governance. Each of these change factors enhances the attractiveness of the transition economies as an international business environment leading to more activities.

The relaxation of institutional constraints upon firms permits local and foreign firms to pursue their preferred business strategies with less restriction than in the centrally planned economies before. Especially foreign firms are accustomed to pursue a differentiation strategy based on superior design, quality, and strong brand appeal.

Moreover, the diminishing participation of government in business is manifested in a withdrawal of subsidies to SOEs (and some other collective enterprises) and the decentralization of business initiative to them. This change implies that firms with government links can no longer enjoy artificial economic rents as they used to during the centrally planned economies. By contrast, some stronger domestic with good governance firms will have the opportunity to raise their own finance in the stock market in the light of the projected banking reform and capital market liberalization. This will make them less motivated to invite foreign participation in their equity ownership, strengthening the national economic resilience, leading to the next propositions.

P2: As government withdraws from direct participation in transition economies' enterprises, weak domestic firms will seek the equity participation of foreign firms.

P3: As government withdraws from direct participation in transition economies' enterprises, stronger domestic

firms with good governance will be less motivated to seek the equity participation of foreign firms; hence strengthening national economic resilience.

The underdevelopment of transition economies business support system in the past was partly due to the previous autarky of SOEs and high levels of government protection. Competitive pressures, and the introduction of new governance like accounting, legal and other standards, are now obliging these and other firms to seek professional support. Standards and policies for the governance of business supporting bodies are similarly being formulated. As the economy becomes increasingly privatized, it is likely that policies on business support services will emerge that suit the needs of privately-owned firms.

P4: The change in the transition economies' legal support for the terms of contracts and of transparency in legal and accounting process will encourage a shift from personal reliance to any authoritative person to impersonal governance of busi-ness transactions.

Despite its many continuing imperfections, the legal system in many transition economies is adjusting from a mode of accommodating conflicts informally (often through personal mediation) as a characteristic of past legal practices to one in which the terms of contracts will be decisive and adjudicated in the courts of law like in the developed countries.

IMPLICATIONS FOR INTERNATIONAL BUSINESS THEORY

The change in transition economies has three related implications for future developments in international business theory. These concern (1) the way the transition is modeled, (2) the need to draw upon multiple perspectives, and (3) the concomitants of contextual approach.

In the modeling of the transition process (e.g., Barkema et al, 1996; Levinthal and March, 1993; Luo and Peng, 1998; Rhenald Kasali, 2006) the common view of transition envisages a process of institutional change emanating from the growing exposure to global material and ideational forces. The exposure is expected to foster the development of efficient markets, business governance and supporting competencies. Institutions defining the contextual rules for business operating in transition economies are expected, in effect, to mediate between global governance forces and the individual firms. This two-stage model of the change process in corporate governance is broadly consistent with the developments in China for example, but requires some reservation in other transition economies with still strong sense of protective state paternalism.

In the need for multiple perspectives (see e.g., Boisot and Child, 1996; Dickson, 1992; Luo, 1999; Miller and Chen, 1994; Shan, 1991; Tan and Litschert, 1994), most attention to the logic of the economic transition has centered on its economic and technological imperatives. This focuses on the creation of efficient markets and the conditions for technology transfer. Both economic theory and the theory of technological change are 'low context' perspectives in that they minimize the impact of national distinctiveness. They presume an eventual convergence as transition economies become more engaged in an increasingly efficient global economy.

In the concomitants of a contextual approach (Child and Tse, 2001; Goodstein and Boeker, 1991; Hannan and Freeman, 1984; Peng, 2000; Wiryawan, 2005), it is suggested that contextualization offers an opportunity for the further development of international business theory. Two inherent characteristics of the transition economies provide insights for such development, namely (1) state paternalism and (2) complexity in transition economies.

China, and to a lesser extent also other transition economies like the former USSR republics in Central Asia, Eastern Europe and Indonesia, exhibit a form of transition from centrally planned economies that retains considerable state intervention in the economy and state sponsorship of firms (e.g., the CEMEX case in Indonesia). State sponsorship is informed by a combination of political and economic motives. It has a long tradition that predates in the protective planned economy period. These states have consistently accorded to themselves a paternalistic role towards business since the incorporation of themselves as rulers.

Even after years of economic reforms, these old practices die hard. State paternalism remains a dominant feature to be reckoned with. Even as former SOEs convert formally into joint stock firms, the state retains much of its controlling role in the corporate governance as, again, like in the case of CEMEX in Indonesia.

Another theoretical challenge is presented by the complexity of transition economies. From the above review of extant literature it can be deduced that change in transition economies is not deterministic in nature, but involves an inter-play between fields of forces operating at different system levels. This view is not only applicable in PRC but also in the former USSR republics and Eastern Europe (Child and Czegledy, 1996). This complexity is being amplified by the way that their leaders are addressing change.

As noted, these leaders are endeavouring to change their countries institutional legacy through a policy of disequilibrium and non-linear progression intended to accommodate basic strains within the system, especially between the goals of reform (or ***REFORMASI*** for Indonesia) and social stability. The inability to apply a simple linear model of transitional change means that firms need new tools to function in dynamic and complex environments. The challenge for the managers is how to model non-linear complexity and analyze its implications.

Complexity-reduction capability (Boisot and Child, 1999) attempts to reduce complexity by bringing it under apparent control through quality corporate governance applying standard policies compatible with modern managerial system. The second option is to try to absorb the complexity through enlisting the support of local allies within the present government or outside. This entails a greater degree of participation in local relational systems and might, therefore, raises the transaction costs of social exchange. This is a theoretical avenue worth pursuing further, particularly if it is combined with an examination

of relevant contingencies. It is also historically the approach adopted by Chinese firms themselves to cope with their environment (Wiryawan, 2005)

CONCLUSION AND DISCUSSION

In this study, it is attempted to assess how firms undertake transformational organizational changes in the transition economies. Taking a continuous view of organizational change, this study examined the drivers of organizational changes in administrative and technical areas (Rhenald Kasali, 2006), and how these changes affect subsequent firm performance. As such, this study heeded De Castro and Uhlenbruck's (1993) and Peng's (2000) suggestions to examine firm-level adaptation issues in transition economies. Apart from that, this present study contributes to the extant literature in two additional ways.

First, the conclusions indicate that continuous organizational changes are driven by a firm's motivation, opportunity, and capability to change, and thereby add to literature that focuses primarily on episodic, eventful changes (see, e.g., Feldman, 2004; Tsoukas and Chia, 2002). In particular, this article concludes that past performance motivates firms to undertake administrative changes, whereas good past performance drives firms to make more technical changes. In a market experiencing unprecedented transitions, firms tend to embrace technical changes more actively, especially when they have the necessary resources (financial or allies).

Participative culture is also indicated to have positively moderated the effects of administrative changes on subsequent performance. Overall, the conclusion is that change plays a positive role in transition economies, supporting the claim from the continuous organizational change camp that change is necessary if not mandatory for firms' success in volatile environments (Brown and Eisenhardt, 1997; Feldman, 2004; Tsoukas and Chia, 2002; Rhenald Kasali, 2006).

As organizational changes are by nature risky and tend to encounter strong internal resistance, firms must recognize and manage those factors that drive or inhibit organizational changes, adopting Lin's (1998) pragmatism. Managers should understand the differences of technical and administrative changes and be able to overcome the possible hurdles of administrative changes and strengthen their effects on performance by eliminating the historical umbilical cord that was rooted in the planned economies. Moreover, when they are performing poorly, firms can legitimate their changes to administrative process more nicely.

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