Chapter 13
Strategically Flexible Capacity Building Driving Emerging Markets Internationalization

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Abstract The research study examined the influence of capacity building in select areas of—skilled workforce, cumulative learning, marketing networks and information technology, on the degree of internationalization amongst Indian firms. The unit of analysis was firms engaged in exporting to developed western markets. Data were gathered through a self-administered survey directed at Owners, Promoters, and Heads of International Business firms involved in strategic decision-making of 200 Indian firms. The firms comprising the sample were drawn from a wide cross section of manufacturing industries including—textiles, apparel and clothing, consumer electronics and pharmaceuticals companies. An array of scaled variables were reduced to meaningful factors in capacity building through EFA, Exploratory Factor Analysis, technique. Thereafter, a CFA, Confirmatory factor analysis through SEM, structural quation modeling was conducted to validate the factors and test the psychometric properties of the variables under consideration. The path diagram, obtained using AMOS software program, indicated how strategic flexible capacity building led to higher degree of internationalization. The findings indicated that capacity building in select areas of, which were primarily factors involved in ensuring flexibility were key to attaining higher levels of internationalization amongst Indian firms.

Keywords Capacity building · Cumulative learning · Internationalization · Manufacturing industries · Marketing networks · Strategic flexibility

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13.1 Introduction

A firm is believed to have strategic flexibility if it is endowed with the capability to rapidly adapt to changes in the external environment. The organization is often faced with major changes in the environment, which mediate quick change of resources, commitment to new courses of action, and to identify markers that can restore the firm back to previous commitments when the external environment goes back to it's initial state. Strategic flexibility is considered as a complex phenomenon wherein the measures can be conceived both before and after triggering of events. Therefore, strategic flexibility can be construed as an offense as well as a defence mechanism.

The principal kinds of strategic flexibility are based upon the following:

- Time taken to respond to change in external environment
- Viable options available to the organization
- Perspective and vitality in establishing strategic direction
- Establishing the core where flexibility is created.

In this chapter, the focus of strategic flexibility would lay on perspective and flexibility created on account of external challenges. This is particularly significant in the context of emerging markets like India, as these markets are very different from their western counterparts. Hence, successful internationalization in emerging economies is largely dependent on their ability to react to rapidly changing external environmental situations. For instance, threats may arise from decline in product margins or entry of a new player in the market with a differentiated product. This is the cause for an upheaval or change in the external environment. These changes would necessitate reallocation of resources to different areas such as R&D, sales force, manpower, etc., in order to maintain its current position in the market. The firm's ability to redirect its resources or react to sudden changes in demand, competitor moves depend strongly on the firm's capabilities. It was felt that directed capacity building could lead to strategic flexibility as a source of competitive advantage for the emerging market firms and would, therefore, have considerable influence on the firm's level of internationalization.

The context of internationalization in Indian firms has always suffered from a volume-based perspective, where the focus is on quantum value of exports rather than the process and degree of internationalization performance. It was felt that a strategic study by way of the firm level capabilities would pave the way for enhancing the internationalization performance of Indian firms. The timing and context of the study is very crucial as India is one of the emerging nations standing on the threshold of a giant leap curve, with the potential to carve out a new trajectory for growth and development. Strategic flexibility, as the new *mantra* for competitive advantage, would add fresh perspective to the performance of internationalization amongst these firms.

13.2 Review of Literature

Flexibility, is an organization's ability to react and accommodate uncertain changes in the environment (Aaker and Mascarenhas 1984). It is so critical that it has become a fundamental assumption of research on competitive advantages for SMEs (Fiegenbaum and Karnani 1991; Volberda 1996). Research has examined organizational flexibility from various perspectives, such as strategic (Tolstoy 2012), structural (Ackroyd 1995; Chaston 1997) and operational (Chappell et al. 1993). However, prior research tends to treat the effects of different types of flexibility as homogenous. It was only later, that studies (Zhang et al. 2014) proved the differing effects of the three types of flexibility on internationalization. In the context of internationalization, some types of flexibility may help companies to respond quickly to uncertain environments, customer needs and hence necessitate the need for diverse deployment of resources. It was found that (Zhang et al. 2014), operational flexibility depleted critical resources of the internationalizing Chinese firms leading to weakening of the competitive advantage and affecting the export performance of these firms. On the other hand, strategic flexibility influenced the export performance in the right direction and improved the competitive advantage of the Chinese firms.

Strategic flexibility refers to capabilities related to the goals of the organization or the environment, and involves changes in the nature of organizational activities (Volberda 1997). Strategic flexibility enables firms to tackle radical environmental changes that are highly unpredictable (Anand and Ward 2004) and irreversible (Rhenman 1973), such as a global economic crisis or the emergence of a breakthrough technology. Firms with strategic flexibility have greater capabilities to cultivate international networks. Relational ties with stakeholders in foreign markets are critical for emerging market firms, because these ties are the bases for relational competence and organizational learning. However, because these firms come late to the market, it is difficult for them to obtain a favourable network position in the existing network centred on incumbents (Lu and Beamish 2001). That is, incumbents have formed business contracts and organizational relationships with stakeholders already in the market. Emerging market firms have neither time advantages, nor the power to fight incumbents for relational resources. The liability of network outsider ship prevents them from exploiting their relational capability, and hinders organizational learning. Although emerging market firms cannot necessarily choose their relational ties, they can build ties through business activities in which incumbents are not yet involved. This type of business is usually one that requires some compromises regarding how business is conducted. The emphasis on fluidity of running a business cannot be under stressed (Sushil 2013, 2014). Strategic flexibility enables emerging market firms to exploit this type of opportunity fully. In addition, firms with strategic flexibility suffer less from inertia and tend to possess fewer deeply embedded organizational routines (Hannan and Freeman 1984; Autio et al. 2000). Firms with strategic flexibility have lower

costs and can react more promptly to meet tricky business requirements, through which they can build networks with more localized firms that are not yet tied to incumbents. With these linkages, emerging market firms can enhance their relational capability cultivated at home and obtain resources and information through organizational learning.

This opens discussion on capacity building as the foundation for strategic flexibility and hence competitiveness of the internationalizing firms. Different types of capacity had been identified in international marketing literature as affecting the degree of internationalization. What follows is a detailed understanding of the building blocks of capacity, so that they could be used in an empirical study. The concept of 'capability' is akin to atoms in a molecule responsible for creating the next level of strategic management, i.e. 'competencies'. The capability of a firm is manifested in various forms like: physical facilities, plant, premises, and skill set of employees, the abilities and expertise of top management (Madhok 1997). Capabilities are the firm's capacity to deploy these assets, tangible or intangible, to perform a task or an activity to improve performance, for example, the capability to offer excellent customer service is marketing capability or to develop new products is product design and development capability (Lorenzoni and Lipparini 1999).

Furthering export performance from developing countries by way of skilled workforce capacity building necessitated recruitment of personnel with—previous work experience in international markets; superior managerial capability from family background of achievement, control, independence, leading to mature internationalization (Ibeh 2004). Studies emphasised on managers trained with formal education (Morris and Lewis 1995) technical qualifications like B.Tech, B.E, enabling better grasp of country specific requirements. Demographics of top managers and other experiential networked resources were cited as variables promoting favourable international performance through skilled workforce capacity building. An interesting study on British Railways' organization resource planning indicated, knowledge of administration in a specific industry as valuable resource in efficient functioning of the company (Barlow 1996). Additionally, (Aaby and Slater 1989; Zou and Stan 1998) strategic intent have also been hinted as the underlying cause for organization resource building, leading to stronger overseas presence in world markets. A special state within the developing country of Pakistan indicated the role played by strategic human resource management in internationalizing behaviour of the organization (Adil 2015).

Capacity building through cumulative learning, is also known as experiential learning. Absorptive Capacity, (Cohen and Levinthal 1990) had been defined as "the capacity to absorb knowledge, which in turn is a function of existing knowledge in markets of prior experience related to customers, ideas and other feedback received in host countries". The study proposed a new approach to learning and innovation, which is vital to the internationalization process of emerging market firms. The concept of "psychic distance", i.e. degree of uncertainty over foreign markets could be overcome through greater knowledge and information about these culturally dissimilar markets (Johanson and Vahlne 1977) had

strong indications of accumulating task specific and location specific knowledge. The study of relatedness of products in case of joint ventures (O'Grady and Lane 1996) and matching organizational routines in case of transnationalisation of retailers (Treadgold 1988) reiterated the need for imbibing know-how from markets in which the firms are operating. The harnessed knowledge would enable the firm to overcome all inhibitions related to foreign markets and propel higher degree of internationalization.

Marketing capacity building included partnerships and alliances with international branded retailers, building support centres and service backup in overseas markets, opening resident sales offices and branches abroad, contracting direct agents or distributors abroad, opening own showrooms or retail outlets abroad, to move towards a higher degree of internationalization, (Thirkell and Dau 1998; Shoham et al. 2002; Madsen et al. 2007). The use of relationship constructs in forging international business partnerships is extremely important for high degree of internationalization (Styles and Ambler 1994). Relationship building in international marketing had swung from a situation of complete ignorance to over emphasis in recent years. Seemingly, it is an extremely important variable affecting the degree of internationalization.

The role of information has been examined in the disciplines of organizational behaviour (Kilman et al. 1983), management (Boisot 1998), marketing (Sinkula 1990) and even export marketing (Souchon and Diamantopoulos 1996). A conceptual model linking the use of market information to organization knowledge and finally to export performance (Toften and Oslen 2003) regaled the need for using technology in harnessing customer feedback, employee viewpoints enabling higher degree of internationalization. The use of information technology to manage large database of important stakeholders and monitor processes involved in international marketing like production, documentation, procurement, sourcing, strengthened the need for capacity building in this area. The order to delivery business cycle of an exporter depended on such processes which could lead or beat the system (Hart and Tzohas 1999). Delays and stagnation at any stage would be detrimental to the export performance of a company in the manufacturing sector, where seasons were very important (Jayalakshmi and Promod 2015). Using the ISM, i.e. interpretive structural modelling technique and further the TISM, i.e. Total Interpretive Structural Modelling, it was proven that ICT, Information communication technology improved the competitiveness of an oil refinery in state of Kerala in India. Information Technology was therefore one of the important factors that allowed emerging market companies to achieve higher degree of internationalization.

The above discussion therefore summarized capacity building into four principal areas—skilled workforce, marketing networks, cumulative learning, and information technology. The research question addressed in this chapter was: *Can strategic flexibility be the source of competitive advantage for achieving higher degree of internationalization amongst Indian manufacturing firms?*

13.3 Research Methodology

This study was based on an empirical investigation of firms involved in exporting to foreign countries from India. The sample of firms came from a wide cross section of industries including apparel and clothing, textiles, pharmaceuticals and consumer electronics manufacturing. The services and extractive industries were deliberately exempted from the study as the variables affecting capacity building in these industries were radically different from the manufacturing sector in the context of Indian exports. The manufacturing exports from India accounted for 44 % of the total exports in 2012–13. Hence, its importance in India's growth story could not be undermined and this sector was duly considered.

The exporters directory from FIEO, Federation of Indian Exporters Organisation, was used as the database for selecting respondents on a purposive sampling basis. The directory was divided into four zones—North, South, West and East of India with subdivisions into cities or towns within these principal zones. A non-probabilistic proportionate sampling method was used with representation of exporters in a fixed proportion from these four zones. The total number of exporting firms in these zones were different. Hence, it was decided that a fixed percentage of 1 % would be maintained from each zone such that a total of 200 firms could be finally represented in the study, out of the total of 30,000 firms included in the directory of FIEO. This way it was ensured that a heavily internationalized zone would be strongly represented in the sample and vice versa. The findings and inferences applied to all the zones universally.

In order to differentiate between firms of high and low degree of internationalization in India, number of years was used as a minimum order criterion. It was seen that (Cavusgil and Zou 1994) the performance of an export market venture could be suitably measured via several characteristics like strategic initiatives, profitability, objectives achieved over a period of 5 years. Conclusively, companies attained a higher order of performance after a period of 5 years in the study. Hence it was deemed suitable to use number of years as the grouping criterion for the internationalizing firms. However, in the Indian context, it was felt that 10 years would be a better splitting criterion as companies in a developing economy would be needing 5 years more than the usual developed counterparts to attain a discerning level of performance or mature degree of internationalization. Therefore, it can be said that Indian firms with 10 years or more in the process of internationalization would be classified as high degree internationalisers and those below 10 years would be the low degree internationalizers. Of the total sample size of 200 Indian firms, considered in the study, it was seen that only 20 firms exceeded the minimum 30 % criterion, and hence qualified as the highly internationalized firms, while the remaining 80 firms were locked into the category of lowly internationalized firms.

In these 200 sample organizations so identified, the Managing Director or Head of International Business (IB)/the Head of Production/Quality Control were only interviewed. In order to eliminate any non-response bias, the survey

was conducted through personal interviews only over fixed appointments. The response rate was 100 %, as all targeted firms were finally surveyed.

In order to conduct a survey amongst the Indian internationalizing firms a validated scale was needed for the study. The necessary construct development used previously engaging studies in emerging markets (Arora and Mittal 2011). The questionnaire so developed was pretested using a small sample of 50 Indian exporters in the manufacturing sector. The capacity building construct was finally made up of a thirty item five-point Likert-scale statements used to probe respondents' assessment (rating) of their firms regarding export-related capacity building (i.e. the extent to which they pursue new technological additions; development of work force; nature of learning at buyer–seller meets, search for export information, attendance at local/foreign trade fairs; and risk taking emphasis on current export returns versus long term marketing objectives). The respondents were asked to indicate their capacity building status through a five-point scale. A scale value of 1 indicated very low capacity building, meaning almost non-existent. A scale value of 5 indicated very high capacity building, meaning sizeable investments and steps taken towards capacity building. It was necessary to use this scaling method as companies were naturally averse to revealing factual data and figures on investments and measures taken for capacity building whereas, ranking their preferences or attitudes towards the dimensions of capacity building was not exactly disclosing their business strategy yet meeting the objectives of this study. This is an important feature of conducting a primary survey in an emerging market scenario.

13.4 Data Analysis

Exploratory Factor analysis was carried out to assess the unidimensionality of the variables and validity, thus suitability of the construct for capacity building leading to higher degree of internationalization amongst Indian firms. The variables in capacity building had been identified from the preceding section on the literature review. All items loaded as intended. The data were considered suitable for factor analysis as the Bartlett's test of sphericity was significant: $0.000 < 0.05$ and KMO measure of sample adequacy (0.890) was greater than 0.60.

The results obtained from Exploratory Factor analysis are summarized in Table 13.1. The presence of eight components with eigen values >1 explaining 79 % of total variance approximately were selected for naming of factors. A test of reliability for the eight factors through Cronbach's alpha was conducted and the values were found to be more than 0.7 in all cases. Therefore, items indicated were considered appropriate for study. The factor loadings for the variables and alpha values for each factor are shown in Table 13.1.

The eight factors so obtained were now named suitably based on a procedure of combining the variables loaded onto one factor, by first adding the statements together and then dividing by the number of statements to arrive at a composite measure for that factor. In this way, each factor could be used as an independent

Table 13.1 Factors for capacity building

Naming of factors	Alpha values for reliability	Variables	Factor loadings
Factor 1 NETWORK capacity building	0.762	Sales and distribution network through independent retail shops and showrooms for brands	0.797
		Distribution network through after sales backup and design centres abroad	0.774
		Capacity building through maintenance of own sales force, in foreign land	0.765
		Capacity building through fixed distributors and agents abroad	0.740
		Distribution network through tie-ups with retail chains abroad	0.726
		Marketing network through local advertising agencies in host countries	0.666
		Distribution network through resident sales office and branches abroad	0.643
		Distribution network through partnerships/alliances with other brands abroad	0.626
Factor 2 ORGANISATION capacity building	0.801	Suitable and conducive working conditions are adopted at factory premises	0.920
		Occupational hazards are duly acknowledged and compensated	0.836
		The level of skilled workforce capacity building through family background	0.770
		Child labour was not employed	0.700
		Skilled workforce capacity building through-technically trained professionals at officers level	0.669
Factor 3 SYSTEMS capacity building	0.877	The level of cumulative learning capacity building through international standards	0.877
		The level of cumulative learning capacity building through new technological advances	0.871
		The level of cumulative learning capacity building through—relatedness of products in case of Joint ventures	0.760

(continued)

Table 13.1 (continued)

Naming of factors	Alpha values for reliability	Variables	Factor loadings
		The level of cumulative learning capacity building through—knowledge of acquired firm	0.658
Factor 4 PROCESS capacity building	0.699	Capacity building in product design and development process using information technology	0.874
		Capacity building in employee database management using information technology	0.742
		Capacity building through recruitments based on number of years in experience	0.728
		Capacity building in sales and distribution process using information technology	0.532
Factor 5 SOURCING capacity building	0.763	Capacity building in customer database management, using information technology	0.871
		Capacity building in procurement process, using information technology	0.823
		Capacity building in production process using information technology	0.677
Factor 6 TRADE capacity building	0.705	The level of cumulative learning capacity building through—task specific knowledge	0.886
		The level of cumulative learning capacity building through—new market information, rules, regulations	0.761
Factor 7 OPERATIONAL capacity building	0.778	Minimum wage rate conditions are adapted at shop floor level	0.855
		Safety of workers is not compromised	0.589
Factor 8 COMMERCIAL capacity building	0.757	Level of cumulative learning capacity building through Location Specific Knowledge	0.658
		The level of cumulative learning capacity building through—new organizational routines	0.592

variable in further data analysis. This composite independent variable therefore assumed the name of the factor which has been explained in the following manner.

The first factor was named as NETWORK Capacity building, extracted from component 1 which included eight variables with >0.6 factor loadings. All the variables were concerned with building capacity in marketing and distribution like retail showrooms, brand presence, maintenance of own sales force, partnerships so on and so forth. The value of the cronbach's alpha for this factor was 0.762, which was high and hence the factor was accepted for further analysis.

The second factor was named as ORGANISATION Capacity building, from component 2 which had five variables with >0.6 factor loadings all indicating capacity building in skilled workforce within the organization. All the variables selected pointed towards development of skilled workforce within the organization in various forms like—occupational hazards were duly acknowledged and compensated; child labour was not employed so on and so forth. The value of the cronbach's alpha for this factor was 0.801, which was high and hence the factor was accepted for further analysis.

The third factor was named as SYSTEMS Capacity building which had been extracted from component 3, which had four variables, all related to capacity building in cumulative learning from overseas markets. All the variables in this factor were concerned with cumulative learning in export markets through technological advances; adaption of international standards, knowledge of acquired firms so on and so forth. Application of international standards to any manufacturing process will automatically improve the systems, popularly known as S.O.P, Standard operating procedures in that organization for better export performance. The value of the cronbach's alpha for this factor was 0.877, which was high and hence the factor was accepted for further analysis.

The fourth factor was named as PROCESS Capacity building, derived from component 4 which had four variables. The variables here included capacity building in information technology used in production processes; sales and distribution process, employee database management; recruitment of personnel with relevant experience. The value of the cronbach's alpha for this factor was 0.699, which was high and hence the factor was accepted for further analysis.

The fifth factor was named as SOURCING Capacity building derived from component 5 which included variables that indicated capacity building made in improved methods through Information Technology in procurement, customer database management and production processes. It was seen that sourcing was a major area of concern in export performance and Information Technology capacity building in this area would greatly improve the overall supply chain of this sector. The value of the cronbach's alpha for this factor was 0.763, which was high and hence the factor was accepted for further analysis.

The sixth factor was named as TRADE Capacity building derived from component 6 which had two variables. The value of the Cronbach's alpha for this factor was 0.705, which was high and hence the factor was accepted for further analysis.

The seventh factor was named as OPERATIONAL Capacity building derived from component 7 which had only two variables. The value of the cronbach's

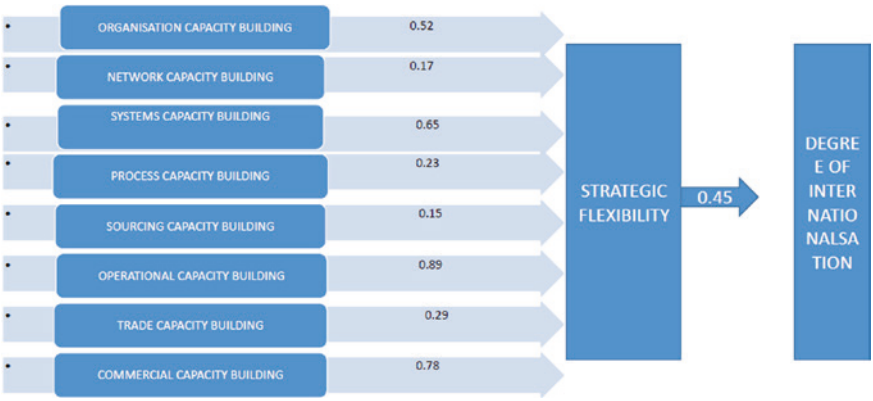

Fig. 13.1 Path diagram for strategic flexibility driven internationalization

alpha for this factor was 0.778, which was high and hence the factor was accepted for further analysis.

The eighth factor was named as COMMERCIAL Capacity building derived from component 8 which again had only 2 variables. The value of the cronbach's alpha for this factor was 0.757, which was high and hence the factor accepted for further analysis.

The eight factors so obtained from EFA was to be further used in model building through SEM, such that the relationship can be established between Strategic flexibility and degree of internationalization (Fig. 13.1).

From the path diagram it can be seen that commercial, operational, systems and organizational capacity building have the maximum influence on strategic flexibility which has a positive influence on the degree of internationalization of the Indian manufacturing firms.

13.5 Conclusion

The competitiveness of the Indian manufacturing firms has been truly manifested in the nature of capacity building leading to strategic flexibility in turn affecting higher degree of internationalization. A closer look at the capacity building factors will evince deeper managerial implications for these firms and set an example for others. The highest loading has been detected for operational capacity building which includes the variables enhancing competitiveness on shop floor like basic wages, compensation, safety issues for workers and such variables as affecting the productivity of the workers in manufacturing firms. It is worth noting here that Indian firms with targeted policies towards operational capacity building have shown greater strategic flexibility than others.

The second highest loading has been found in favour of commercial capacity building which includes variables like location-specific knowledge and new

organizational routines. It is evident that managers in international business need to ensure greatest understanding of the markets in which they operate to institutionalize strategic flexibility into the organisation. Location-specific knowledge would include country specific learning like local laws, political situation, cultural changes which can cause uncertainties and fluctuations in demand.

The next highest loading is in favour of systems capacity building followed by organisation capacity building. The systems capacity building factor was particularly strong on international standards and regulations along with variables affecting the workings of a strategic alliance through joint ventures or mergers and acquisitions. This is a very important dimension of Strategic flexibility as the success of the alliance has a role to play in higher internationalization performance of the firm. The adoption of certifications on ecological standards like OEKOTEX, GOTS are extremely important in apparel and textiles industries as the developed counterparts are taking these marks very seriously on the exported products.

The organisation capacity building factor consisted of variables relating to skilled workforce enhancement through provisions of good hiring and maintenance policies of blue and white collared workers. The emphasis is on employing professionally or vocationally trained personnel who can imbibe challenges fast making use of their training instead of relying on forces of nature.

Together it seemed that the four factors in capacity building combined a huge source of competitive advantage evident in the strategic flexibility experienced by the Indian firms. This positively affected their internationalization performance and led to higher degree of internationalization.

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