

## Research Article

### An Organizational Economics Approach to Organizational Change in Emerging Economies

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**Abstract:** Organizational change in Transitional economies is influenced by multiple political, historical and economic factors not present in established market economies. This study proposes an organizational economics approach to organizational change in emerging economies. Based on transaction cost economics and resource based view, the cost of change is proposed as a mediator of change and perceived commitment to transition is proposed as antecedents of cost of change for organizations in emerging economies. The proposed approach has practical implications for government and organizations concerned with long-term development in emerging economies. It may provide a useful lens in studying the impact of government policies on organizational change in transitional economies.

**Keywords:** Organization economics, organizational change, transitional economies

#### INTRODUCTION

Transitional economies are the countries and markets undergoing change from a centrally planned economy to a market-based economy (Suhomlinova, 2006). Two main features of transitioning economies are rapid pace of economic development and a transition from planned to market economic system (Hoskisson *et al.*, 2000). Transitional economies are gaining increasing attention with their contribution to the world economy and the rich opportunities they provide for studying change (Hoskisson *et al.*, 2000; Suhomlinova, 2006). Understanding the various dynamics in these economies that drive organizations to change could prove of value to organizational decision makers as well as investors.

Researchers interested in change in transitional economies have studied institutional change (Child and Tsai, 2005) and the changes in resources, organizational ties (Peng, 2003) and the agency problems under such transitions (Aghion and Blanchard, 1996). The growing importance of transitional economies in the world economy, as well as, the growing research on the changes occurring in these economies makes two questions increasingly prominent: first, given the rapid economic changes and faced with the multitude of decisions involved in organizational change, at what point does an organization decide to invest in making significant changes and second, what factors are involved in pressing the organization to invest in change? The answer to these questions may help us

predict change, both at the organizational level and subsequently at the country level, in transitional economies.

In this study we apply the economic concept of “Substitution at the Margin” to define a “Cost of Change” model to explain organizational change and then propose key variables that contribute to calculating the cost of change in transitional economies. We illustrated these variables with examples and a discussion of the theory and its implication concludes the study.

#### MATERIALS AND METHODS

**Substitution at the margin and the costs of organizational change:** Change, at its simplest level, means doing things differently. Lewin (1951) noted that organizational change could be understood through the assessment of “forces”, both internal and external, that affect the organization. He referred to organizations as normally functioning in a quasi-stationary state, where the forces pressing for change are counterbalanced by forces opposing change. Understanding these forces allows one to understand and predict when change is likely to occur, as well as intervene to encourage and direct change. Organizational economists employ the notion of Substitution at the Margin (SAM) to ascertain when economic factors imply an organizational change should occur (Coase, 1937).

By way of illustration, in the early stage of a new organizational practice, the cost of adopting the change

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can be significant. This expense is a function of the cost of changing the existing systems and the cost of exploring the new practice or structure and the pioneers have to bear with possible failures (Zimmerman and Zeitz, 2002). Thus, when an organized practice or structure is new and the cost of adopting it is higher than the COA the change, firms tend not to adopt the new practice or structure, unless they perceive a significant benefit from being the first to adopt. This situation has changed when the new practice becomes increasingly mature. When the new practice is adopted by more firms and the practice becomes familiar with more firms, the cost of adopting decreases and at the same time the COA the change increases.

As more firms have adopted the new practice or structure, stakeholders of a firm that have avoided the change may suspect the legitimacy of the firm. The firms may find the pressure from stakeholders such as clients, stakeholders and government agencies and the loss of legitimacy; actually cost them business and financing opportunities (Scott, 2008). When the COA the change becomes greater than the cost of adopting the change, SAM that favors the change occurs and the firm is likely to adopt the new practice or structure. This assertion leads to the first proposition.

**Proposition 1:** Firms are likely to adopt a change in practices when SAM favors the change or  $C_{OA} > C_{AD}$ .

**SAM in transitional economies:** In transitional economies, some forces affecting organizational change are more salient than in either centrally planned or market economies. Some scholars discuss change in relation to the institutional environment (Child and Tsai, 2005) some look at organizational resources in transitional economies (Uhlenbruck *et al.*, 2003) some examine transactional uncertainty in emerging economies (Choi *et al.*, 1999) and some focus on managers as decision makers and agents in transitional economies (Aghion and Blanchard, 1996). These studies emphasize the importance of forces such as an institutional environment in studying organizations in transitional economies. Another force that has enjoyed the sizeable attention in transitional economies in the past years is outsourcing which brings in both job opportunities and asset specificity to many firms in transitional economies. An analysis of SAM for organizational change in relation to these four forces follows.

**Perceived government commitment to transitional:** Decision making is based in-part upon judgments of what is going to happen in the future (Knight, 1921). In order to operate and compete, firms must make investments, as well as operational decisions, based on a prediction of future events and environments. To decision makers, “the whole calculation is in the future; past and even present conditions operate only as grounds of prediction as to what may be anticipated”

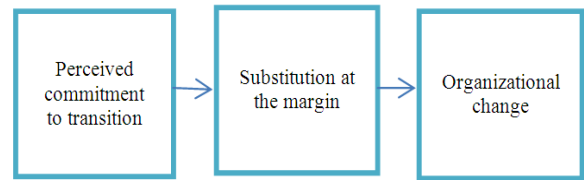


Fig. 1: SAM in transitional economies

(Knight, 1921). Besides, Political and economic uncertainties are characteristic of transitional economies (Hoskisson *et al.*, 2000; Peng, 2003).

Perceived Commitment to Transitional (PCT) of government policy in a transitional economy reduces the perceived risks of more market-based changes in the organization. Government policies perceived as committed to a consistent direction give firms and their decision makers the confidence about the future. An open and liberalizing economic policy perceived as stable encourages firms that have practices designed for a planned economy to adopt practices that fit a market economy. If an open and liberalizing economic policy is perceived as unstable, it discourages firms from adopting changes that fit in a market economy. Instead, firms will adopt fewer changes to avoid the risk of unfitness in the future if the government’s policies were to revert to a controlled economy. In other words, firms that do not perceive a governmental commitment to market policies tend to put off organizational changes until the risk of change is perceived as low compared to the benefits gained from the changes. If firms have the autonomy to decide on their own changes, when the firms’ management perceives that the government is committed to open and liberating market policies, the COA organizational change is greater than the cost of adopting organizational change. SAM occurs under this circumstance in such a way that it favors organizational change. This argument leads to the second proposition.

**Proposition 2:** In a transitional economy, SAM that favors change is positively associated with the degree of perceived governmental commitment to transit (Fig. 1).

The proposed antecedents in this approach can be measured in a variety of ways. PCT can be measured with instruments that test the perception of organizational decision makers of the government’s determination to change. Field studies with these measurable constructs may yield important understanding of organizational change in transitional economies.

## RESULTS AND DISCUSSION

Understanding SAM and a small set of highly salient factors, both internal and external, that describe that cost can help organizational decision makers make effective decisions about when organizational change is

necessary and potentially effective in transitional economies. When SAM occurs, the organization is more likely to change. Understanding perceived governmental commitment to change should help managers and investors understand when change can be successful and researchers better understand why some changes are more effective than others. Depending on their degree of presence, we believe that these factors contribute to change decisions by tipping the balance of the status quo and creating SAM the point where decision makers feel the need to change.

Our approach to organizational change in transitional economies may have practical implications for the management in these economies for example, at the state level, government officials should be aware of the effect their policy-making behaviors have on organizational decisions. Any government move is regarded as an indicator of the future direction of policy change. If the government wants to ensure organizational change toward the direction of a market economy, the government should be cautious with changes in their economic policy. Policies that encourage more market activities should be implemented according to the pace of development of that country. Policies that appear capricious and contradictory to the market principles should be avoided. The proposed approach should remind governments of transitional economies to take caution both when making policies and when considering possible policy changes.

Although the propositions in this study are developed with transitional economies in mind, their application may not be limited to transitional economies. Some features commonly considered as specific only to transitional economies may be found in any transitional-involved economies (Peng, 2000). Even in a market economy, political changes and economic shocks may cause organizations to reconsider their strategy and structure and adopt changes as a consequence. The recent economic recession, for instance, prompted the U.S. automobile industry to rethink innovation and move slowly away from the asset specificity associated with the traditional technology. Coincidentally, the level of government intervention in organizational affairs and the change in the distribution of information about scarcity during the economic recession is yet another

example of where organizations in market economy might find themselves in transitions.

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