© Academy of Management Review
1996, Vol. 21, No. 2, 492–528.

THE GROWTH OF THE FIRM IN PLANNED ECONOMIES IN TRANSITION: INSTITUTIONS, ORGANIZATIONS, AND STRATEGIC CHOICE

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Highlighting an important facet of diversity among organizations operating in different institutional environments, this article presents a model of the growth strategy of the firm in planned economies in transition such as Eastern Europe, the former Soviet republics, and China. Focusing on the stylized state-owned enterprises, we explore the interaction between institutions and organizations in these countries. Given the institutional constraints, neither generic expansion nor acquisitions, two traditional strategies for growth found in the West, are viable for firms in these countries. Instead, firms settle on a network-based strategy of growth, building on personal trust and informal agreements among managers. The institutional environment that leads to this unique strategy of growth is examined, and boundary conditions, limitations, and implications of this model are discussed.

The economic problem of society is mainly one of rapid adaptation in the particular circumstances of time and place.
—Friedrich Hayek (1945: 524)

The growth of the firm has been studied extensively in the West (Chandler, 1962; Penrose, 1959). A stylized firm in this research stream is an organization that has substantial discretion over the allocation of its resources and the formulation and implementation of its competitive strategies (Porter, 1980). What this literature assumes is that the focal firm operates in a market-based economy, is motivated to grow, and has a number of strategic choices that it can adopt to achieve growth (Child, 1972, 1994). It is unclear, however, whether such research done in the West will have any bearing on the firm in planned economies in transition such as Eastern Europe, the former Soviet republics, and China (Boyacigiller & Adler, 1991;

Earlier versions of this article were presented at the Academy of International Business annual conference in Maui, Hawaii, in October 1993 and at the Jackson School of International Studies at the University of Washington in May 1995. We thank Sherri Johnson, James Kulman, Juergen Maurer, Richard Moxon, Melissa Schilling, three anonymous AIB reviewers, and four anonymous *AMR* reviewers for their helpful comments.

Shenkar & Von Glinow, 1994). The socialist legacy as well as the recent transformations in these countries present an institutional environment that is immensely different from what a typical Western firm would encounter (Ericson, 1991; Kornai, 1992; Peng, 1993, 1994). A stylized firm in such an environment is an organization that differs from its Western counterpart in many dimensions: It is typically state-owned and lacks complete discretion to acquire and allocate resources, with little experience and confidence to compete in a market-based economy (Child, 1990; Lawrence & Vlachoutsicos, 1990). Given these differences, exploring the growth of the firm in planned economies in transition will highlight an important facet about the *diversity among organizations* that operate in different institutional environments (Carroll, 1993; Hannan & Freeman, 1989; Lammers & Hickson, 1979).

For a theory of the growth of the firm to be complete, it seems that more research should be directed toward the firm in planned economies in transitions. As formerly planned economies have undertaken fundamental transitions toward market-based economies since the 1980s, improved knowledge about firm behavior in these countries has become more important both for theory and practice. For organizational researchers, the transitions in these countries offer fascinating grounds to refine and test existing theories and to develop new ones (Boisot & Child, 1988; Carroll, Goodstein, & Gyenes, 1988). For Western managers, despite the attractiveness of these newly opened markets, stories of business failures resulting from lack of understanding of local firms abound (Peng, 1995; Staber & Aldrich, 1994); increased interactions with indigenous firms in these countries are frequently accompanied by frustration and failures (Pearce, 1991; Puffer, 1994; Stross, 1990). As such, improved understanding of the growth of the firm in these countries will not only have theoretical contributions toward a more complete theory of firm growth, but it will also have enormous practical implications for Western firms aiming at improved effectiveness when dealing with their counterparts in formerly planned economies.

In the West, a *three-strategic-choice* model dominates the growth of the firm. Traditionally, Western firms grow through one of the two basic strategic choices: generic expansion or acquisitions (Penrose, 1959; Yip, 1982). More recently, Western firms have been increasingly interested in a *hybrid* or *network* strategy to achieve growth (Contractor & Lorange, 1988; Powell, 1990; Williamson, 1991). Selecting an appropriate strategy of growth requires top management to inventory the internal strengths and weaknesses of the organization, as well as evaluate the opportunities and constraints the environment presents (Chandler, 1962, 1990; Child, 1972; Lawrence & Lorsch, 1969; Porter, 1980; Thompson, 1967).

Does this three-strategic-choice model for growth apply to firms in planned economies in transition? Do firms there have the motivation to grow? If so, do they achieve growth through one of the three routes listed above? Guided by these three key questions, this article identifies a model of the growth of the firm that features a process of what we call *boundary* *blurring* to illustrate the diversity among organizations operating in different institutional environments. Although resembling the hybrid model for growth in the West, this *neither-market-nor-hierarchy* strategy of growth follows from the interaction of the unique institutional frameworks and economic organizations in these countries (Peng, 1993, 1994).

Our research builds on North's (1990) argument that it is the interaction between institutions and organizations that shapes economic activities. Specifically, we focus on the formal and informal constraints of the institutional environment in these formerly planned economies and explore their effects on the choice of network-based growth strategies. Although the use of network-based strategies in turbulent environments is hardly an emergent or a new phenomenon (Powell, 1990), the importance of network strategies in formerly planned economies has only received scant and isolated attention in the literature. Previous authors in this area limited their attention to one country (e.g., Burawoy & Krotov [1992] and Elenkov [1995] on Russia; Carroll et al. [1988] and Kornai [1990] on Hungary; Nee [1992] and Xin & Pearce [1994] on China). The primary contribution this article makes is to advance this stream of research beyond any single country setting and link the literature on firm growth with the context of the institutional frameworks in a broad range of formerly planned economies. Through such *multinational* triangulation efforts (Peng & Peterson, 1994), we hope to be more successful at identifying those components of institutional frameworks critical to a theory of the growth of the firm.

Of course, Eastern Europe and the former Soviet republics are not one country, but many. Even China might be thought of as several smaller regions with different levels of economic development. Despite the tremendous differences among these countries, there are a number of compelling reasons that we can consider them as one group of countries.[1] First, their common experience under the Soviet-type central planning regime and communist ideology suggests that "they are all members of a broader, clearly identifiable class of social-political-economic systems" (Kornai, 1992: 5). Second, their phenomenal transitions toward market-based economies, albeit with different speed and pace, have led to similar changes in their institutional infrastructure, such as weakened bureaucratic controls and tolerance of private ownership (Brus & Laski, 1989; Fischer & Gelb, 1991; Peng, 1994). Finally, strategic choices adopted by various enterprises there share a similar feature of relying on network contacts and personal trust to minimize uncertainties in a changing environment (Burawoy & Krotov, 1992; Carroll et al., 1988; Xin & Pearce, 1994). In sum, common

[1] This practice of focusing on these countries as one group of transitioning economies can be found in Fischer and Gelb (1991), Kornai (1992), Nee and Stark (1989), and Peng (1993, 1994), among others. North (1990: 137) and Williamson (1991: 294) also treat these countries as a group without deliberating on the differences of individual countries. A similar example is North's (1990: 54) explanation of the overall poor performance of Third World economies without highlighting the differences among various Third World countries.

heritage and transitions as well as similar adaptive strategies for firm growth have led us to collectively call these countries *planned economies in transition* and explore firm strategies for growth as a group there.

The remainder of the article begins with a review of the firm growth literature drawing on the *strategic choice* perspective (Child, 1972). Then, following North (1990), we explore the interaction between institutions and organizations as well as the resultant strategic choices. The following section introduces some background on the institutional frameworks in formerly planned economies, highlighting both formal and informal constraints. Then we identify the network-based strategy of growth, followed by a discussion on the boundary conditions, limitations, applicability, and implications of this model.

THE GROWTH OF THE FIRM IN THE WEST: A STRATEGIC CHOICE PERSPECTIVE

The literature on the growth of the firm includes some of the best known classics in management, such as Chandler (1962, 1990), Cyert and March (1963), Nelson and Winter (1982), Penrose (1959), and Williamson (1975, 1985). As a multidimensional construct, firm growth primarily involves expansion of organizational size measured by assets and employees; increase in volume of sales, profit levels, or activities; as well as generation of new economic functions or more lines of products and services (Chandler, 1962; Eisenhardt & Schoonhoven, 1990; Greiner, 1972; Kimberly & Miles, 1980; Penrose, 1959; Starbuck, 1965).

Although three major strategies of growth have been identified (i.e., generic expansion, acquisitions, and networks), a key assumption permeating the three-strategic-choice model is that the firm operates in a market economy in which it is relatively free to pursue its own strategic choices (Child, 1972). The strategic choice perspective argues that the analysis of firm strategy "must recognize the exercise of choice by organizational decision makers. The boundaries between an organization and its environment are defined in large degree by the kinds of relationships which its decision makers choose to enter" (Child, 1972: 10). For example, to many observers, Western firms seem to have a *lingering love affair* with growth (Peters, 1992). The motivation for growth is fueled by top management's desire to provide more complete and better lines of products and services, as well as the excitement of associating with a growing organization in employment size and asset base. A large number of strategy researchers have generally adopted the strategic choice perspective (Child, 1994: 13; Hrebiniak & Joyce, 1985; Miles & Snow, 1978; Whittington, 1988), suggesting that "strategic choice is the critical variable in a theory of organizations" (Child, 1972: 15).

Thus, the analysis of the growth of the firm must start with the role of the organizational decision maker, the desire of top managers to undertake a strategy of growth, and their ability to make strategic choices (Eisenhardt & Schoonhoven, 1990). Building from this framework, next we outline three major theoretical perspectives of firm growth and then derive a synthesis of the three-strategic-choice model on firm growth in the West.

The Evolutionary Perspective on the Growth of the Firm

The evolutionary perspective, pioneered by Penrose (1959), focuses on both the desire of top managers to achieve growth, as well as the firm as a bundle of resources and routines that influence growth. According to Penrose, each firm is a collection of productive resources, which include both physical resources (e.g., plant, equipment, land, raw materials, inventory) and human resources (e.g., skilled and unskilled labor, managerial and technical services). The growth of the firm can be viewed as an attempt by top managers to fully utilize these resources. Firms grow into new areas when the excess capacity in currently underutilized resources can be utilized more productively. Thus, such internally generated growth becomes *generic* expansion. Apparently, there is a limit to such growth. In Penrose's model, the principal constraint of generic growth is not the accessibility of physical resources, but rather the availability of capable, experienced managers who must spearhead the growth.

To augment Penrose's (1959) work, Nelson and Winter (1982) argued that firm resources not only consist of physical and human resources, but also include another important dimension, organizational routines. Such routines are the administrative mechanisms that are required to transform inputs into outputs. The efficiency of a firm is a function of its routines, which are the product of its cumulative organizational history. Diffused throughout the organization, these routines are not embodied in any one individual. As such, organizational routines take on a tacit nature, thus making articulation of such routines difficult (Kogut & Zander, 1992; Levitt & March, 1988). When the firm grows, the availability of managers experienced with the firm's organizational routines to transmit this information to new members of the firm becomes a prerequisite for the growth. Thus, echoing Penrose (1959), Nelson and Winter (1982) suggested that the boundaries of a growing firm are constrained by its managerial capabilities.

In sum, the evolutionary perspective articulates the incremental process of the generic expansion strategy and suggests that the prerequisites for such growth are a firm's managerial and organizational capabilities (Penrose, 1959).

The Transaction Cost Perspective on the Boundaries of the Firm

According to the transaction cost perspective, in addition to having a staff of capable managers, a growing firm must also overcome transaction cost problems. It explains why the full employment of underutilized resources sometimes cannot be achieved by selling or leasing out the excess capacity to other firms but often requires an expansion of the boundaries of the firm (Teece, 1982). Otherwise termed as the *market failure* framework, this view focuses on the failure of the market, even in modern market economies in the West, to facilitate the exchange of certain types of resources (Coase, 1937; Williamson, 1975, 1985). As a result, a firm attempting to fully employ its underutilized resources will often discover that it has no choice but to expand its boundaries to avoid its firm-specific knowledge from being exposed to, and exploited by, its competitors. In other words, the firm often has to engage in mergers and acquisitions of other firms in order to achieve such growth through *internalization* (Haspeslagh & Jemison, 1991). For mergers and acquisitions to take place successfully, there must be efficient strategic factor markets such as financial markets so that firm ownership can be smoothly transferred (Jensen & Ruback, 1983).

There is also a limit to such growth because of the existence of bureaucratic costs, which are the hierarchical equivalent of transaction costs (Jones & Hill, 1988; Williamson, 1985). Bureaucratic costs mainly stem from the problem of *control loss* because of information-processing constraints in complex organizations (Cyert & March, 1963; Jones & Hill, 1988). The amount of information a grown firm will have to process and coordinate is geometrically greater than before (Hill & Hoskisson, 1987). Therefore, firm growth is constrained by the firm's capability to overcome bureaucratic costs in the growth process. The limit of such growth is reached when the economic benefits yielded by previously underutilized resources are outweighed by the bureaucratic costs of managing the additional size of the firm.

In sum, the transaction cost perspective focuses on the relative costs and benefits between the strategic choices of generic expansion and acquisitions, which are a variation of the *hierarchy-or-market* decision (Williamson, 1975, 1985).

The Interorganizational Perspective on the Growth of the Firm

Although the traditional strategy for growth has been either through generic expansion or acquisitions (Penrose, 1959; Yip, 1982), more recently an unprecedented number of Western firms have been entering a variety of interorganizational relationships in order to achieve growth (Contractor & Lorange, 1988; Powell, 1990). These network-based relationships take on various forms, such as strategic alliances, joint ventures, hybrid organizations, partnerships, corporate groups, and research consortia (Borys & Jemison, 1989; Browning, Beyer, & Shetler, 1995; Jarillo, 1988; Johanson & Mattsson, 1987; Ring & Van de Ven, 1994; Tallman & Shenkar, 1994; Thorelli, 1986). Even though different in forms, these interorganizational relationships all share the same characteristic in that, cast in transaction cost terms, they represent a compromise, hybrid form of governance that is neither market nor hierarchy (Hennart, 1993; Williamson, 1991).

The motivations for Western firms to enter these interorganizational relationships vary, including risk sharing and gaining access to new technologies and markets, scale economies, and complementary skills, to name just a few (Kogut, 1988; Oliver, 1990). Taken together, the strategy of growth through network formation reflects the focal firm's inability to possess all the necessary resources to undertake generic expansion alone or to merge and acquire other firms. Rather, such a strategy for growth represents the firm's efforts to reduce environmental uncertainties through development of interorganizational relationships (Pfeffer & Salancik, 1978). However, because of their hybrid nature, interorganizational relationships are notoriously difficult to manage, and failure rates are high (Miles & Snow, 1992; Parkhe, 1993). Their success and failure depend on whether partners can develop enough trust and mutual understanding so that potential problems can be worked out (Browning et al., 1995; Powell, 1990). Similar to the transaction cost logic, the benefits of undertaking this strategy for growth will be exhausted once the costs of managing such complex interorganizational relationships become prohibitive (Harrigan, 1986; Hennart, 1993).

In sum, the interorganizational perspective focuses on the rise of a network-based, hybrid strategy of growth and highlights the neither-market-nor-hierarchy feature of such strategy.

The Growth of the Firm: A Synthesis of the Western Model

Taken together, the streams of research reviewed above, permeated by the strategic choice perspective, lead to a three-strategic-choice model (Table 1) with the following key propositions:

> *Proposition 1: Firm growth is driven by the strategic choice for growth adopted by top managers.*
>
> *Proposition 2: The firm is considered to be a collection of resources, which include physical and human resources as well as organizational routines.*
>
> *Proposition 3: The existence of excess resources is a precondition for such growth. The principal motivation for growth is the desire to fully employ underutilized resources.*
>
> *Proposition 4: The firm has three basic strategic choices for growth: (a) undertake generic expansion, (b) conduct mergers and acquisitions, and/or (c) develop interorganizational relationships, which correspond to hierarchy, market, and hybrid modes of organizing, respectively.*
>
> *Proposition 5: The growth of the firm is limited by two constraints: (a) its capability to articulate and codify its organizational routines and transmit this information to its members and (b) its ability to overcome transaction cost and bureaucratic cost problems incurred in the course of growth.*

As noted earlier, the three-strategic-choice model is derived from research on the growth of the firm in the West. This approach has been developed within a very distinct institutional framework, characterized by a relatively free market economy in which Western firms can adopt certain strategic choices to pursue growth (Child, 1972; Hickson & McMillan, 1981; North, 1990). Given the vastly different institutional environments in formerly planned economies, it seems critical to investigate the generalizability of the Western model developed previously to those countries. Because the notions around institutional frameworks are so central to our arguments, we will develop these concepts in the next section.

TABLE 1
The Growth of the Firm: A Three-Strategic-Choice Model

Strategic Choice	Mode of Organizing	Institutional Prerequisite
Internal, generic expansion	Hierarchy	Capable managers
Mergers and acquisitions	Market	Functioning strategic factor (e.g., financial) markets
Interorganizational relationships (*i.e.*, networks)	Hybrid (neither hierarchy nor market)	Trust and mutual understanding

INSTITUTIONS, ORGANIZATIONS, AND STRATEGIC CHOICE

Institutionalism as a theoretical perspective has its roots both in sociology and economics (Scott, 1992). Sociologists focus on the legitimacy-defining role that institutions take on. They address some widely shared beliefs that shape the way people in a society think and behave, beliefs that can arise out of shared cultural and political systems (Powell & DiMaggio, 1991; Scott, 1987, 1992; Zucker, 1987).

An alternate institutional perspective from economics represented by North (1981, 1990; Davis & North, 1971) addresses similar issues. North (1990: 3) argued that the institutional framework of a society serves as constraints to regulate economic activities by providing the *rules of the game*. The institutional framework is defined as "the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution" (Davis & North, 1971: 6). Institutions shape history by structuring political, social, and economic incentives in economic exchange. These limits to the set of choices of individuals and organizations provide a stable structure—although not necessarily efficient—to economic exchanges, thereby reducing uncertainty (North, 1990). Obviously, both the sociological and economic approaches to institutionalism are complementary to each other (Scott, 1992). A combination of the two is natural and will be used in this article.

According to North (1990), the institutional framework is made up of both formal and informal constraints around individual and organizational behavior. Formal constraints include political (and judicial) rules, economic rules, and contracts. Informal constraints, on the other hand, include codes of conduct, norms of behavior, and convention, which are embedded in the culture and ideology. In situations where formal constraints fail, informal constraints will come into play (North, 1990; Powell, 1990; Scott, 1987, 1992; Zucker, 1987).

Institutional frameworks interact with both individuals and organizations (North, 1990; Powell & DiMaggio, 1991; Scott, 1992). They influence individuals' decision making by signaling which choice is acceptable and determining which norms and behaviors are socialized into individuals in a given society. Institutional frameworks also affect the actions of organizations by constraining which actions by those organizations are acceptable and supportable within the framework (Aldrich & Fiol, 1994; Hillman & Keim, 1995). In other words, institutions provide the rules of the game in which organizations act and compete. Such interaction between institutions and organizations shapes economic activities. Specifically, "both what organizations come into existence and how they evolve are fundamentally influenced by the institutional framework. In turn, they influence how the institutional framework evolves" (North, 1990: 5). For example, Porter (1990) examined how the institutional framework in a country affects its international competitiveness. Relatedly, Davis and North (1971) focused on the role of the institutional framework in the United States, which has stimulated its economic development. Similarly, Hill (1995) demonstrated how the institutional framework in Japan helps create its competitive organizations. Therefore, any analysis of firm behavior, such as the growth of the firm, must take into account the nature of the institutional framework.

Given the influence of institutional frameworks on firm behavior, any strategic choice that firms make is inherently affected by the formal and informal constraints of the institutional framework (North, 1990; Oliver, 1991). In other words, "organization and environment permeate one another both cognitively and relationally" (Child, 1994: 12; Hickson & McMillan, 1981). Much of the literature on the growth of the firm in the West reviewed earlier does not discuss the specific relationship between the strategic choices and the institutional frameworks. The free-market-based institutional frameworks have been taken for granted by most writers in strategic management (Hickson & McMillan, 1981). This is unfortunate because strategic choices are selected within, and constrained by, the institutional frameworks. It is the institutional frameworks in the West that lead to certain strategic choices for growth (Davis & North, 1971; Hillman & Keim, 1995; North, 1990). Given the tremendous amount of diversity between the institutional frameworks and organizational forms in the West and in formerly planned economies (Carroll, 1993; Lammers & Hickson, 1979), next we first explore the institutional frameworks in the latter before we examine how they affect the strategy for growth there.

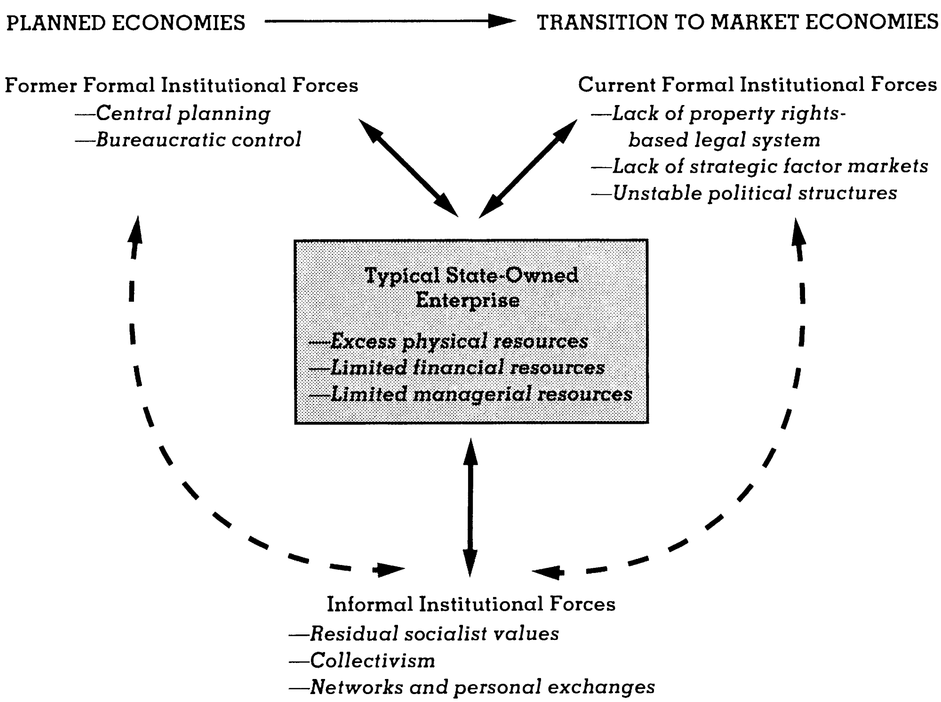
INSTITUTIONAL FRAMEWORKS IN PLANNED ECONOMIES IN TRANSITION

North noted that "economic (and political) models are specific to particular constellations of institutional constraints that vary radically both through time and cross sectionally in different economies." He (1990: 110) further wrote, "The models are institution-specific and in many cases highly sensitive to altered institutional constraints." As a result, any attempt to explore a firm's strategic choice requires an understanding of the institutional framework in which the firm is embedded. In this section, we outline the formal and informal constraints of institutional frameworks in Eastern Europe, the former Soviet republics, and China (see Figure 1 for an overview). The consequences of these institutional forces on the growth of the firm will be dealt with in the next section.

The Institutional Frameworks Before the Transitions: Formal Constraints

As opposed to market economies, the most fundamental feature of planned economies is the comprehensive use of central economic planning and bureaucratic control. The planning regime in the latter fulfills most functions that the market fulfills in the former (Child, 1990; Ericson, 1991; Kornai, 1992; Tung, 1982). Before the transitions, "a national plan was developed by the central government and then was incrementally decomposed into a set of targets and orders for specific [state-owned]

FIGURE 1
The Interaction of Institutions and Organizations in Formerly Planned Economies



firms" (Carroll et al., 1988: 235; Adam, 1989; Naughton, 1990, 1994). Such a system bears striking similarities to a multidivisional firm (the M-form) in market economies, with the central government acting as the corporate headquarters and state enterprises as its divisions (Carroll et al., 1988; Peng, In press). Whereas the Soviets call their economy a "single national economic complex" (Spulber, 1991: 23), Macleod (1988: 39) even suggests that "China, Inc." can be the "ultimate conglomerate."

Under these formal constraints of a highly centralized organization, the typical firm before the transitions was usually a state-owned enterprise that took order from the planning regime, as opposed to an independent decision-making unit, which a Western firm would be (Child, 1990; Ericson, 1991; Tung, 1982). With *soft budget constraints* (Kornai, 1980), the pre-transition firm was not quite as concerned about profitability because the government would automatically write off its debts and provide operating funds. Thus it had little incentive to improve financial performance. As a result, under the central planning regime there was neither motivation nor room for firm growth in the form of sales, profit, or new products (Lawrence & Vlachoutsicos, 1990; Pearce, 1991; Shenkar, 1991; Spulber, 1991).

Overall, the formal constraints in pre-transition planned economies manifest themselves in the planning regime that the state adopted in order to bureaucratically control economic organizations. Although other formal constraints such as the political ideology and the party apparatus also control individuals and firms (Shenkar & Von Glinow, 1994), the most important firm-level formal constraints have been the planning regime that asserts its overwhelming effect on firm behavior (Lawrence & Vlachoutsicos, 1990; Naughton, 1990, 1994).

The Institutional Frameworks During the Transitions: Formal Constraints

Since the 1980s, fundamental changes in the institutional frameworks in these countries have occurred, which, in turn, have directly affected the growth of their firms. The most notable change in formal constraints has been the gradual dismantling of the central planning regime, replaced by more market-based transactions to facilitate economic exchange (Brus & Laski, 1989; Naughton, 1994). In other words, the formal constraints from the planning regime have been weakened during the transitions. However, at the same time, the necessary formal constraints of a market-based economy, namely, a well-defined property rights-based legal framework, have also been lacking in these countries (Clarke, 1991; Litwack, 1991). As a prerequisite for markets to function smoothly, a property rights-based legal framework enforced by the state brings the costs of transacting through markets under control. According to the World Bank (1985: 10), "a decentralized market economy cannot function properly without a comprehensive system of commercial laws." Lack of such a legal framework as formal constraints would lead to high transaction costs (North, 1990).

In the past, planned economies were ruled by power relations and bureaucratic controls (Adam, 1989; Ericson, 1991; Perkins, 1988). The state policed firms through its bureaucratic control to curb opportunism and allocate resources, albeit inefficiently. With plenty of bureaucratic controls and regulations, there was little need for formal laws to define exchange relationships among economic actors (Kornai, 1992). During the transition, as the state gradually relinquishes its role in policing economic exchanges, state firms are granted more and more autonomy; the government is increasingly tolerating more private ownership of private and collective firms that are outside the state sector. Increased exchanges among autonomous economic units call for an adequate legal framework that enforces property rights (North, 1990). But the establishment of such a legal framework takes a long time, and formerly planned economies all lack the capacity to rapidly build legal infrastructure (Clarke, 1991; Litwack, 1991; Peng, 1993, 1994). The lack of an adequate legal framework to define and protect property rights has resulted in a sharp rise in opportunistic behavior (Boisot & Child, 1988; Puffer, 1994). Put another way, an economy transitioning toward market-based measures without an adequate legal framework is a place for opportunism, and transaction costs are bound to be high.

In addition, the lack of a property-rights-based legal framework is also accompanied by the lack of political certainty in these countries. In China, where the communist party still holds power, the reform process has experienced a great deal of ups and downs, characterized by years of political liberalization and reaction, the most notable case being the setback in June 1989. Such fluctuation in the political arena has generated a great deal of uncertainty for the business community (Beamish & Spiess, 1991). For example, instead of expanding private ownership and privatizing state-owned enterprises, the Chinese government has made repeated attempts to block such a move and to bail out insolvent state firms (*Business Week,* 1995; Perkins, 1988). Chinese managers report in a survey that among eight environmental factors that have an impact on firm performance, they perceive the state regulatory regime to be the most influential, most complex, and least predictable (Tan & Litschert, 1994). The same is true in Eastern Europe and the former Soviet republics, where the ownership issue is a political minefield despite the removal of the ideological barrier for privatization (Fischer & Gelb, 1991: 98; Kornai, 1990, 1992; Puffer, 1994). Political reaction against initial bursts of spontaneous privatization in Hungary, Poland, and Russia resulted in their suspension. Nationalist sentiment puts limits on the role of foreign ownership (Fischer & Gelb, 1991). All these have created an unstable political structure that is not conducive for reducing uncertainty, thus further increasing transaction cost problems for firms attempting to grow in such an environnment.

Relatedly, the lack of an adequate legal framework and the lack of a stable political structure have resulted in the underdevelopment of strategic factor markets (Barney, 1986), such as financial markets that would ensure the proper transfer of ownership. Because "price-making [strategic factor] markets require well-defined and enforced property rights" (North, 1981: 42), such strategic factor markets are one of the most important preconditions for both the successful sale of state assets and the independent development of private firms. Although some scholars have argued for rapid, outright privatization of state firms in formerly planned economies (Lipton & Sachs, 1990; Sachs, 1989), another group of experts has argued for a more realistic and gradual approach, given the underdeveloped state of strategic factor markets in these countries (Murrell & Wang, 1993; Kornai, 1990, 1992). Even if privatization is fully supported by the new political regime, the sheer number of state firms that have to be privatized poses a great challenge for the vulnerable institutional infrastructure of these countries. Worldwide, fewer than 1,000 firms were privatized between 1980 and 1987. But Hungary has about 2,000 state enterprises, and Poland, 7,500, to cite just two countries (Fischer & Gelb, 1991: 99). Zhou (1993) suggested that assuming one Chinese state firm is auctioned off per week, a reasonable rate given the present state of financial markets in China (*Business Week*, 1995; Xia, Lin, & Grub, 1992), 4,000 large state firms would take 80 years to privatize unless significant capital comes from abroad. However, foreign investors from the West have been hesitant to commit a large amount of investment unless the strategic factor markets in these countries are well established and ownership transfer is less problematic (Beamish & Spiess, 1991; Staber & Aldrich, 1994). All these testify to the difficulties for firms to grow without adequate financial markets that facilitate transfer of assets and ownership.

In sum, the changing formal constraints in planned economies in transition have had three mutually reinforcing characteristics: (a) lack of a property-rights-based legal framework, (b) lack of a stable political structure, and (c) lack of strategic factor markets. Overall, these formal constraints are characterized by extreme volatility and unpredictability, which, as will be shown later, have a strong bearing on the strategic choice of the firm for growth.

The Informal Constraints Before and During the Transitions

North (1990: 6) noted that "although formal rules may change overnight as the result of political and judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are much more impervious to deliberate policies." As noted earlier, during the transitions, previous formal constraints (i.e., the planning regime) have been weakened, and the formal constraints for a market-based economy (i.e., legal framework, political stability, and strategic factor markets) have also been lacking. As a result, informal constraints play a larger role in regulating economic exchanges in these countries during the transition (North, 1990) and have considerable influence over both the behavior of individuals and firms, as well as the generation of new formal constraints (see Figure 1 for illustration).

The primary informal constraints come from the network contacts that are extensively used to coordinate economic activity before the transition (Peng, 1993, 1994). "Virtually every Soviet enterprise has an employee who works as an 'expeditor' (*tolkach* [Russian]), whose primary responsibility is to establish long-run personal relationships with other organizations for the purpose of procuring needed supplies, particularly in emergency circumstances" (Litwack, 1991: 98; Grossman, 1977; Shlapentokh, 1989). Vertical relationships between superiors and subordinates, between planners and enterprise managers, also tend to be highly personal and involve extensive bargaining (Litwack, 1991; Naughton, 1990). Managers commonly give large gifts (*prinoshenie* [Russian]) to superiors in the ministerial and party apparatus (Grossman, 1977; Puffer, 1994). These gifts are generally not bribes in the sense of being a direct exchange for specific goods and services at one moment in time; they are an investment in a long-term personal relationship (Xin & Pearce, 1994; Zucker, 1987).

Of course, these networks predated the market-oriented transitions in these countries (Boisot & Child, 1988; Burawoy & Krotov, 1992; Carroll et al., 1988; Stark, 1992). During the transitions, preexisting networks of affiliation are activated, and network ties become much more important as informal constraints (Elenkov, 1995; Nee, 1992; Peng, 1993, 1994; Stark, 1992). The propensity of using networks and personalized exchanges certainly depends on the cultural embeddedness of such a practice (Child, 1980; Granovetter, 1985; Hofstede, 1980). One might argue that, in China, such practices might be more widespread because of that country's Confucian tradition of collectivism (Earley, 1993; Kao, 1993). However, the notion of collectivism is not limited to China. Collectivism has also been empirically shown in workers in the former Yugoslavia, the only East European country in Hofstede's (1980) sample. They were found to exhibit a high level of collectivism, similar to what Hofstede reported in two Chinese societies, Hong Kong and Taiwan. Moreover, even in those countries without a strong history of Confucian collectivism or empirical support for network ties stemming from a collectivist culture, existing evidence suggests that *structural imperatives* of a Soviet-type economy, especially the lack of a legal infrastructure, also necessitate the widespread activation of, and extensive reliance on, personalized network-based exchanges (Grossman, 1977; Litwack, 1991; Schlapentokh, 1989; Stark, 1992). In other words, although arising from different sources, the notions of *blat* (connections) and *mir* (collective) in Russia are perhaps as important as *guanxi* (connections) in China (Puffer, 1994; Xin & Pearce, 1994). Informal constraints, then, can either arise from a country's long cultural tradition or emerge as a consequence of more formal constraints (North, 1990).

In sum, a great deal of network-based personalized exchanges can be found in planned economies both before and during the transition. Reducing uncertainties in economic exchanges during an extremely volatile period, they consist of an important part of the informal constraints, or a set of dominant logic (Prahalad & Bettis, 1986), that shapes the institutional frameworks. They become more important during the transition because they offer some constancy and predictability in times of fundamental change in the formal institutional frameworks.

Summary

In this section, we have described the institutional frameworks in planned economies in transition, highlighting both formal and informal constraints. In addition, we have argued that, whereas formal constraints have changed from the planning regime and bureaucratic controls to more market-based measures, the transition process has been volatile and uncertain, without an adequate legal framework, a stable political structure, and functioning strategic factor markets. On the other hand, informal constraints characterized by network-based personalized exchanges have continued to have a bearing on firm behavior—perhaps even more so during times of flux.

THE GROWTH OF THE FIRM IN PLANNED ECONOMIES IN TRANSITION

Since the 1980s, a great number of institutional changes have fundamentally influenced economic organizations operating in planned economies in transition, most notably on the growth of the firm. In this section, we draw on the three-strategic-choice model of the growth of the firm in the West identified earlier, combined with the institutional constraints in formerly planned economies, to explore the distinct model of firm growth in these countries. While acknowledging the emergence and influence of entrepreneurial private and collective firms during the transitions (Jones & Maskoff, 1991; McCarthy, Puffer, & Shekeshnia, 1993; Nee, 1992), we follow Lawrence and Vlachoutsicos (1990) and Shenkar and Von Glinow (1994) to focus on the growth of the stylized state-owned enterprises, which tend to be the mainstay in these economies. Using the Western model as a benchmark, we concentrate on the interaction between institutions and organizations (North, 1990). Specifically, we explore the following: (a) Does the institutional framework during the transition allow for strategic choice for growth? (b) Do firms there have excess resources that motivate growth? (c) Do they grow through generic expansion or acquisitions? (d) Do they grow through developing interorganizational relationships?

Strategic Choice for Growth

As noted earlier, the typical state firm during the pretransition period would have neither motivation nor room for pursuing a strategy of growth (Adam, 1989). In fact, the notion of competitive strategy sounded very foreign to most managers in planned economies, who were used to taking orders from the state and considering plan fulfillment as their primary objective (Lawrence & Vlachoutsicos, 1990; Pearce, 1991; Puffer, 1994; Sharma, 1993; Walder, 1989).

The transition from a planned economy to a market-based economy "changes fundamental managerial assumptions, criteria and decision making, and represents a genuine transformation of the business" (Tan & Litschert, 1994: 3). It is a time when an organization may have to "strategize" in order to respond to changes in the environment (Oliver, 1991). The change in the formal constraints embodied in the planning regime is a major environmental shift. Gradually, the state relinquishes its role of administering central economic plans and assuming financial responsibility of state firms. Instead, state firms are granted an increasing amount of autonomy as well as financial independence to compete in the transition economy (Walder, 1989).

Although these firms are newcomers to the game of competition, they are nevertheless under stress to learn the game fast. First, a great number of Western firms, including many powerful multinationals, have penetrated their markets and created tremendous pressure for local firms (Stross, 1990). Second, many state firms have switched from supplying their previously closed markets to selling to the West, which pays hard currency on one hand, but also demands a great deal of competitive and sophisticated products on the other hand. As a result, firms are prompted to upgrade their technological and organizational skills (Elenkov, 1995; Lardy, 1992; Staber & Aldrich, 1994). Finally, the loosened institutional environment has also introduced a new force in the competitive arena, namely, a new class of private and collective firms that are more entrepreneurial than their counterparts in the state sector (Jones & Maskoff, 1991; McCarthy et al., 1993; Nee, 1992). All these challenges have created an environment in which the typical state firm can no longer afford to be passive now but has to join the competition.

For many state firms in planned economies in transition, to compete means to grow, or to find better ways to exploit underutilized resources (Penrose, 1959). Given the competitive conditions, the need to adopt certain strategies for growth becomes relevant and necessary (Oliver, 1991). It is important, however, to note differences in even what is meant by firm growth in this context. For firms in the West, growth means an expansion of organizational size, measured by employees, asset base, sales, profits, and/or the scope of product and service offerings (Chandler, 1962; Greiner, 1972; Kimberly & Miles, 1980; Peters, 1992). State firms in formerly planned economies typically have already had a large asset base and/or large number of employees (see the next section). Subsequently, their growth is primarily in offering more complete and better lines of products and services so that they will become more financially sound and more competitive in an increasingly market-based economy, generating potentially more sales and profits (Burawoy & Krotov, 1992; Kornai, 1992; Shenkar, 1991; Walder, 1989).

Excess Resources

The Western model posits that the existence of excess resources is a precondition for firm growth (Penrose, 1959). Whereas Penrose highlighted two types of resources that a firm can have (i.e., physical resources and human resources), we will add financial resources in our discussion, because the latter is often the preliminary step for acquiring further resources for growth.

Physical resources. The typical firm in formerly planned economies, usually a state-owned enterprise, often commands a huge amount of excess physical resources because of its inefficient way of operations under the planning system. The prevailing "economics of shortage" (Kornai, 1980) in planned economies creates bottlenecks in input material. Therefore, the pressure to meet the plan leads firms to hoard everything, from raw materials to human resources (Kornai, 1980, 1992; Walder, 1989). A ratio for this inefficiency is the *Kornai ratio*, which measures the ratio of input inventories versus output inventories (Kornai, 1980, 1992). The higher the Kornai ratio, the worse the conditions of shortage and hoarding behavior (Perkins, 1988; Walder, 1989). For example, as Table 2 shows, during 1981–1985, the Kornai ratios for manufacturing firms in six planned economies were all substantially higher than those in market economies. In other words, many firms in planned economies operate a *just-in-case* system to hoard physical resources, which is in contrast to the *just-in-time* system pioneered by the Japanese. As a result, excess physical resources can often be found.

Moreover, because of the underdevelopment of strategic factor markets in these countries as a result of the lack of legal infrastructure, the

TABLE 2
The Kornai Ratio of Input Versus Output Stocks: International Comparison

Manufacturing Enterprises	1981–1985[a]	1984[b]	1985[b]
Planned Economies			
Bulgaria	5.07	—	—
China	—	4.4	3.8
Czechoslovakia	3.07	—	—
Hungary	6.10	7.3	8.5
Poland	4.49	—	—
Soviet Union	3.16	9.2	12.3
Market Economies			
Canada	0.92	—	—
Japan	1.09	—	—
Sweden	0.81	—	—
United Kingdom	1.02	—	—
United States	1.02	0.9	1.2
West Germany	0.71	—	—

[a] From *The Socialist System: The Political Economy of Communism*, by J. Kornai, 1992: 250. Copyright 1992 by Princeton University Press. Reprinted with permission.

[b] From "Reforming China's Economic System," by D. H. Perkins, 1988. *Journal of Economic Literature*, 26: 618–619. Copyright 1988 by American Economic Association. Adapted with permission.

sale and lease of such physical assets are problematic (Clarke, 1991; Litwack, 1991). Therefore, a growing firm will have to find better use of these excess resources. Finally, because of the collectivist mentality and the remaining *socialist legacy* from years of state policy that provided a strong safety net, managers in these firms are less likely than their Western counterparts to see *downsizing* as a viable option for dealing with excess resources. Instead, these managers would be more inclined to seek to employ these resources within the firm.

Managerial resources. In addition to physical resources, a staff of capable managers to help steer the growth process and transmit organizational routines to new members is also a prerequisite for growth, especially for a generic expansion strategy (Chandler, 1962, 1990; Penrose, 1959). Although the typical state firm in planned economies is larger than its Western counterpart measured by the overall size of employment (see Table 3 for an illustration), it usually does not have enough skilled managers trained to compete in a market-based economy (Puffer, 1992, 1994; Stross, 1990). The current state of management talent is a direct result of years of socialization under the institutional framework of these formerly planned economies. Specifically, decades of operations under the rigid central planning system have made managers at these firms become agents of the government, whose primary function was to take orders from the top, and innovation and entrepreneurship were not valued. As most managers of state-owned firms were selected for their position because of their political loyalty, they are simply not equipped to work in the context of markets because of their lack of knowledge, skills, and experience in such an environment (Pearce, 1991; Puffer, 1994; Sharma, 1993; Shenkar, 1991; Walder, 1989).

With the help from the West, there are massive training efforts in every planned economy in transition attempting to upgrade managerial skills of current managers and to train a new generation of able managers (Puffer, 1992; Stross, 1990). But the effects of such training take place slowly, and firms in these countries have to grow immediately. In addition, much of what is being taught may not translate into instant improvement because of the different context that produced Western management expertise in the first place (Boyacigiller & Adler, 1991).

In sum, the lack of capable managers skilled at running market-based operations has created a peculiar situation. On the one hand, the competitive pressures introduced during the transitions necessitate the strategic choice for growth. On the other hand, the lack of managerial resources poses a severe constraint on growth, especially for a generic expansion strategy.

Financial resources. For many physical-resource-rich state firms in formerly planned economies, the lack of capable managers is also compounded by the lack of adequate financial resources to fund growth. Several reasons contribute to the current state of financial problems. First, state firms in planned economies were used to receiving a large sum of

TABLE 3
Size Distribution of Manufacturing Firms: Planned Economies Versus Western Economies, 1970[a]

	Planned Economies[b]	Western Economies[c]
All the Manufacturing Firms		
1. Average number of employees per firm	197	80
2. Percentage of those employed by large firms[d]	66%	32%
The Textile Industry		
1. Average number of employees per firm	355	81
2. Percentage of those employed by large firms	75%	17%
The Ferrous Metal Industry		
1. Average number of employees per firm	2,542	350
2. Percentage of those employed by large firms	95%	79%
The Machinery Industry		
1. Average number of employees per firm	253	82%
2. Percentage of those employed by large firms	61%	28%
The Chemicals Industry		
1. Average number of employees per firm	325	104
2. Percentage of those employed by large firms	79%	35%
The Food-Processing Industry		
1. Average number of employees per firm	103	65
2. Percentage of those employed by large firms	39%	16%

[a] From *The Socialist System: The Political Economy of Communism,* by J. Kornai, 1992: 400. Copyright 1992 by Princeton University Press. Reprinted with permission.
[b] Sample includes Czechoslovakia, East Germany, Hungary, and Poland.
[c] Sample includes Austria, Belgium, France, Italy, Japan, and Sweden.
[d] *Large firms* are those firms that employed more than 500 people.

investment capital from the state planning regime (Kornai, 1980, 1992). Now, with the state becoming increasingly unwilling or unable to sustain a high level of investment, firms' primary source for financial resources, which they took for granted, has been cut off. Second, the inefficiency in many state firms has generated many unsellable goods, thus draining their limited cash flow. This is especially problematic for many Eastern European firms, which traditionally served the Soviet markets. While losing their traditional markets, they have yet to generate products that are competitive in the West (Staber & Aldrich, 1994). As a result, their current output is stockpiled, and many firms simply produce *for the warehouse.*

Finally, the underdevelopment of strategic factor markets such as financial markets, which we noted earlier, has made these firms unable to raise enough capital of their own (McKinnon, 1991).

As a result, many state firms in planned economies in transition are running at a loss with a heavy debt load. Still more of them are irretrievably insolvent (Staber & Aldrich, 1994). To be sure, things are changing, and some preliminary form of financial markets in which firms can raise capital has been established (*Business Week*, 1994, 1995; Xia et al., 1992). However, the underdevelopment of these markets, permeated by the lack of a property-rights-based legal framework, has resulted in only marginal improvement. Investors from the West, after the initial euphoria, have become increasingly frustrated (Peng, 1995). Overall, there is not an extensive amount of investment capital available to firms in planned economies in transition.

In sum, the typical state firm in planned economies in transition is characterized by excess physical resources and shortage of managerial and financial resources. These resource conditions provide a set of parameters within which state firms in these countries attempt to grow. The residual socialist ideology of keeping everyone employed and the fear of social unrest resulting from massive layoffs have made the state hesitant to engage in large-scale privatization (Fischer & Gelb, 1991; Naughton, 1994; Staber & Aldrich, 1994). This also has an impact on the choices that individual managers in these firms make as they attempt to find uses for excess human resources rather than eliminating the workforce as their first option. Moreover, the underdevelopment of financial markets for selloff provides powerful incentives for managers to attempt to employ underutilized resources, rather than just dumping them.

Growth Through Generic Expansion or Acquisitions?

Having established that managerial motivation for growth exists during the transition, as well as the existence of excess physical resources that calls for improved utilization, we will examine whether firms in these countries grow through generic expansion or acquisitions, the two traditional strategies for growth suggested by the Western model.

As noted previously (Table 1), each strategy for growth has its preconditions. For generic expansion, a staff of capable managers to help steer the growth process and transmit organizational routines to new members is a prerequisite (Penrose, 1959). Currently, the lack of a large number of managers familiar with the workings of a market-based economy is one of the major management challenges for firms in planned economies in transition (Puffer, 1992, 1994; Sharma, 1993). Management talents often have to be imported (Stross, 1990). However, given the vast need for capable managers in these countries, such a practice is hardly a solution. Moreover, Western managers often work in these countries on a short-term, temporary basis, without fundamentally affecting the capabilities of local managers in these countries.[2] As a result, generic expansion becomes problematic because of the lack of capable managers.

In the case of mergers and acquisitions, the firm not only needs to have excess resources and capable managers, but also has to operate in adequately regulated financial markets supported by a property-rights-based legal framework (Jensen & Ruback, 1983). Otherwise, no mergers and acquisitions can take place, except for politically motivated reasons ordered by the government.[3] Given the underdeveloped legal and financial infrastructure in these countries, the restoration of property rights is a long and tardy process (Fischer & Gelb, 1991; Kornai, 1990). Despite some improvements, planned economies in transition still lack clear laws on mergers, bankruptcy, and collateral, thus leading to serious distortions in trading (Clarke, 1991; Litwack, 1991; Staber & Aldrich, 1994). The engagement of Western firms is also hampered by the chaotic and uncertain situation. The underlying source for such difficulty is the volatile and uncertain institutional framework, notably the unstable political structure that does not vigorously promote privitization, as well as the ill-defined property rights that create problems for ownership transfer. In short, without mature and well-regulated strategic factor markets such as financial markets (Barney, 1986; Jensen & Ruback, 1983), the ownership and value of state assets is unclear, privatization difficult, and the route for firms to grow through mergers and acquisitions treacherous. The slow pace of privatization throughout Eastern Europe, the former Soviet republics, and China all testify to these difficulties (*Business Week*, 1994, 1995).

Overall, the combination of the lack of capable managers and of strategic factor markets, embedded in an institutional framework shaped by poorly defined property rights and an unstable political structure, has made it difficult for firms to grow via generic expansion or acquisitions. The problems associated with both internal and acquisitive growth are heightened by the countries' capital shortage, which is itself the result of the lack of certain key institutions commonly found in the West, such as a well-functioning banking system and capital markets. As a result, both traditional strategies of growth typically adopted by Western firms are not readily available for firms in these countries. As such, an alternative strategy of firm growth seems warranted.

Growth Through Boundary Blurring: A Network-Based Strategy

As noted previously, given the institutional uncertainties, transaction costs are bound to be very high during the transition (Boisot & Child, 1988).

[2] Even in unified Germany, the practice of West German firms active in East Germany has been to transfer Western managers on a temporary basis and then to "repatriate" them, rather than to build upon the competencies available in the East (e.g., Staber & Aldrich, 1994).

[3] For example, until 1992, Chinese firms were not allowed to acquire other firms based on their own initiatives. The so-called consolidation, in many cases, has been arranged and ordered by the state in an effort for profitable state firms to rescue ailing ones (*Business Week*, 1995; Wu, 1990).

Thus, such an environment would lead firms to *internalize* transactions to avoid turbulence (Williamson, 1975, 1985). Firms in planned economies in transition do try to internalize the transactions. However, being denied the routes of growth through internal expansion and/or acquisitions, they have to take a different route to internalize transactions, namely, through forming networks of firms, a growth strategy that can be characterized as networking or boundary blurring (Peng, 1993, 1994).

Following North (1990), we posit that it is the interaction between institutions and organizations in such an environment that has led to a strategic choice of adopting a network-based strategy of growth. The loosening of the planning regime, a set of primary formal constraints before the transition, has allowed for strategic choices for growth (Tan & Litschert, 1994). But the current formal constraints are not conducive for strategies of growth through generic expansion and acquisitions. As a result, the dominant logic (Prahalad & Bettis, 1986) of relying on personalized exchanges leads top managers at the typical state firm to choose a network-based strategy of growth, building networks as strategic alliances to facilitate economic exchanges while avoiding the politically difficult task of ownership transfer.

As jargon used in business, *networking* means knowing the *right people,* making connections to get something accomplished, and working together by using people within a system to reach common objectives. In the recent academic literature, networking is defined as a firm's effort to establish long-term relationships with other firms in order to obtain and sustain a competitive advantage (Jarillo, 1988; Johanson & Mattsson, 1987; Laumann, Galaskiewicz, & Marsden, 1978; Lincoln, 1982; Oliver, 1990; Ring & Van de Ven, 1994; Thorelli, 1986). As a form of organization that is neither market nor hierarchy (Powell, 1990), networks help overcome a firm's problem of not having enough resources to accommodate growth, while avoiding substantial bureaucratic costs in internalizing operations. In such a context, firm boundaries are *blurred* in that multiple network connections can be found, but direct ownership is rare. Put differently, a networking strategy allows a firm to tap *external resources* that are used but not directly owned (Jarillo, 1989).

Although very few managers at state firms in these countries are capable of functioning in a market-based economy, most of them are good at cultivating network relationships under the planning regime (Litwack, 1991; Puffer, 1994). It is well accepted that it is impossible to be a successful manager in a planned economy without continually relying on personal contacts. When the formal constraints embodied in the planning system are weakened, and the new formal constraints for a market-based economy are still lacking, managers naturally resort to informal constraints to regulate transactions and seek growth because of their *dominant logic* in using networks and personalized exchanges (Peng, 1993, 1994; Prahalad & Bettis, 1986). They engage in extensive networking activities based on personal contacts and informal agreements through a great deal of trust building, gift giving, and/or bribery (Nee, 1992; Xin & Pearce, 1994). Based on these efforts, firms form loosely structured networks on the basis of *guanxi* or *blat* (connections in Chinese and Russian) to coordinate activities, pool resources, and pursue joint growth.

Compared with internal, generic expansion and growth through mergers and acquisitions, a strategy of growth through networking has its distinct advantages in these institutional environments. A generic expansion strategy is essentially a continuous internalization process with increasing bureaucratic costs (Williamson, 1975, 1985). Mergers and acquisitions, on the other hand, would not only increase bureaucratic costs when firms are merged, but also incur substantial transaction costs when operating in the financial market to acquire other firms (Jensen & Ruback, 1983). A network-based growth strategy would, of course, incur a great deal of transaction costs as the firm sets up an elaborate web of relations based on its relative competitive positions vis-à-vis other firms (Jarillo, 1988; Johanson & Mattsson, 1987; Powell, 1990; Thorelli, 1986). However, as long as the costs of networking, such as gift giving, are lower than the costs of otherwise being unable to complete the necessary transactions, there can still be transaction costs savings. Moreover, a growth strategy of boundary blurring would incur much less bureaucratic cost, because it does not require substantial formal transfers of ownership rights.

In a volatile and uncertain environment, networks stabilize economic activities by having members engage in reciprocal, preferential, and mutually supportive action (Peng, 1993, 1994; Powell, 1990). During the transition, when the government often issues confusing and conflicting announcements, one has no particular reason to take any announcement seriously (e.g., during the Russian coups in 1991 and 1993). Therefore, information passed through networks from reliable sources becomes far more trustworthy. In other words, information passed through networks is *richer* and more useful (Daft & Lengel, 1986), thus saving search costs, a source of transaction costs, and allowing network members to make more informed decisions. Such information passed through the networks can be especially helpful to select the right partner with whom to network (Contractor & Lorange, 1988; Parkhe, 1993). In other words, networks constructed by managers who have known each other and established a basic level of trust and mutual understanding save on search costs in a period of extreme uncertainty and volatility (Gulati, 1995).

In addition, the network-based strategy of growth can lead to efficiency improvement in this environment over other growth strategies. Networks provide flexibility of resource allocation in an environment where needed factor mobility is severely constrained and administrative intervention by the state is still extensive. Although direct, formal ownership transfer might be difficult, firms within a network can be relatively free to transfer resources to pursue joint growth (Burawoy & Krotov, 1992; Wu, 1990). By pooling and coordinating resources, economies of scale and scope can be achieved, and organizational learning can occur. Specifically, members of a network that have been exposed to Western technology and management through licensing or joint ventures may help diffuse such knowledge throughout the network. As a result, better utilization of excess resources can be accomplished, and more competitive products can be generated (Elenkov, 1995).

Consistent with our arguments, it appears from the limited research currently available on the subject that the principal strategy of growth undertaken by firms in formerly planned economies has been a network-based model featuring boundary blurring (Peng, 1993, 1994). For instance, in the former Soviet republics, the collapse of the planning regime in the late 1980s and early 1990s led firms to organize industry associations to rationalize production through extensive bargaining (Burawoy & Krotov, 1992). Some even suggest that Soviet all-union enterprises have now become network-based multinationals in the new republics (Filatotchev, Buck, & Wright, 1992). In China, enterprise groups started to emerge in the early 1980s and are now a widespread form of governance structure (Wu, 1990). Similar networking activities can be found in Eastern Europe, where individual firms are unable to achieve effective internal growth but, by forming networks, they can team to face riskier challenges (Carroll et al., 1988; Kornai, 1990; Stark, 1992).

In sum, although networks and personalized exchanges have always been an important aspect of firm behavior in planned economies, such activities take on added importance for the growth of the firm during transition. Given both formal and informal constraints in the current institutional environment, the growth strategy of the firm in formerly planned economies features boundary blurring through extensive networking with other firms.

DISCUSSION

A major purpose of this article is to explore the interaction of institutions and organizations in the context of the transitions from planned economies to market-based economies in order to illustrate the diversity among organizations operating in different environments. We argue that the unique formal and informal institutional forces in these countries have made it difficult for firms to grow via generic expansion and acquisitions. Moreover, the combination of the formal and informal institutional forces explains why there is a rapid emergence of network organizations in these countries that attempt to achieve growth. Several key questions remain: Under what conditions does this model hold? Does it apply for all firms, all industries, and all countries that are formerly planned economies? What are the limitations of such growth? How does the model pertain to the growth of the firm in the West? Below, we address these questions by discussing the boundary conditions, limitations, applicability, and implications of this model.

Boundary Conditions

Throughout the article, we have followed Lawrence and Vlachoutsicos (1990) and Shenkar and Von Glinow (1994) to focus on the *typical state firm* that used to operate under the central planning regime and is now under competitive pressure attempting to grow. Such a stylized state-owned enterprise, instead of a newly founded private or collective firm, exhibits the largest amount of variance in many dimensions when compared and contrasted with a typical Western firm, thus enabling us to fully illustrate the diversity among organizations operating within different institutional frameworks. We suggest that the network-based model of growth is mostly applicable to this type of firms.

During transition, a great deal of organizational diversity can be found, including not only among state firms but also a large number of entrepreneurial start-ups in the private and collective sectors (Jones & Maskoff, 1991; McCarthy et al., 1993; Stark, 1992). However, this model of growth will not change substantially if we incorporate private and collective firms. Because of the fear of the *liability of newness* (Aldrich & Fiol, 1994; Hannan & Freeman, 1989), newly founded private and collective firms would also have to resort to networking in order to achieve survival and growth. For these young firms without the protection of a property-rights-based legal framework, the harassment from the state remains a constant danger. Such an uncertainty necessitates a *defensive* strategy to compensate for their lack of institutional protection in an uncertain environment. In fact, many registered *collective* firms in these countries are private firms in disguise (Nee, 1992; Stark, 1992). Under these circumstances, Nee (1992) suggested that *collective hybrids,* networks formed between the collective and state sectors, have an institutional advantage over purely private firms. Specifically, institutional protection, a nontradeable political resource (Boddewyn & Brewer, 1994), can be shared by private and collective members of such networks. Moreover, these firms, compared with state firms, have a *stronger* incentive to network with other firms as well as government officials (Nee, 1992; Peng, 1993, 1994; Xin & Pearce, 1994). This is also consistent with the resource-dependent model in that external linkages may increase the legitimacy of the new firm, thus improving its chances for survival (Pfeffer & Salancik, 1978; Singh, Tucker, & House, 1986). In other words, one would also observe a similar network-based strategy of growth among private and collective firms in these countries, but for a different reason.

Does this model apply to all industries? We suggest that the more dynamic and entrepreneurial an industry is, the more applicable this model becomes. The reasoning, again, is based on North's (1990) thesis on the interaction between institutions and organizations. In industries that the state for various reasons has maintained strong control, such as transportation, telecommunications, and defense industries, the room for individual firms to achieve growth through a network-based strategy will be minimal. On the other hand, in *deregulated* industries where the state holds the minimal amount of control, the room for entrepreneurs to maneuver through networking will be more extensive, and the amount of growth will be more noticeable. China's agricultural and rural industries stand as the most entrepreneurial examples to which this model of growth may apply (Byrd & Lin, 1990; Nee, 1992).

Does this model apply to all countries that are formerly planned economies? We contend that the model pertains to most formerly planned economies as long as their institutional frameworks exhibit some transitional attributes we identified earlier, such as a previous planning regime, the introduction of market competition, and the lack of adequate legal and financial infrastructure.[4] Of course, the interaction between institutions and organizations varies by national contexts (Child, 1980; Hickson & McMillan, 1981; Hofstede, 1980; North, 1990). We are neither assuming all these countries in this group (i.e., Eastern Europe, the former Soviet republics, and China) are in the same stage of transition, nor are we assuming uniform organizational growth without allowing for organizational diversity.[5] We are simply suggesting that, given the formal and informal institutional forces in such an environment, a network-based strategy of growth will be the dominant strategy, which should not be confused as the *only* strategy. Indeed, as is true for any economy in any period, a multiplicity of governance structures and growth strategies can be found in these countries in transition, including generic expansion, acquisitions, and networks (Peng, 1993, 1994; Stark, 1992). What is argued here is that the latter will become a dominant strategic choice for growth during the transition.

Limitations of the Network-Based Growth Strategy

As with every strategy of growth, enterprise networks cultivated through personal contacts and informal agreements are not without their share of problems. To a certain degree, the boundaries of a growing firm are constrained by the firm's ability to codify its routines and transmit this information to its members (Kogut & Zander, 1992; Nelson & Winter, 1982). Historically, the typical firm in planned economies is a single plant enterprise (Kornai, 1992; Perkins, 1988). Coordinating the activities of an enterprise network with several member firms requires a geometric expan-

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[4] Following this line of reasoning, this model will not be very applicable to state-owned firms in Cuba or North Korea, where the notion of market-based competition has not been introduced yet. On the other hand, the model will find increasing validity in Vietnam, which has implemented a number of market-based measures in recent years.

[5] In an earlier paper, Peng (1994) provided an illustration of different forms of networks found in China, Hungary, and Russia. He reported that, even though differing in origin, scope, and density, "networks of all sorts have mushroomed during the transition stage, ranging from the huge, loosely structured Commonwealth of Independent States to closely held clan organizations" (1994: 236).

sion of the firms' information-processing capacity (Hill & Hoskisson, 1987). Many firms in planned economies in transition lack this capacity. Moreover, in an uncertain time, managers' extensive networking activities, often with a dubious nature such as gift giving, make them extremely reluctant to codify their routines (Boisot & Liang, 1992; Xin & Pearce, 1994), thus rendering further growth problematic.

In transaction cost terms, enterprise networks are a compromise form of governance that is neither market nor hierarchy (Powell, 1990; Williamson, 1991). Instead of being a strategic choice by design, such network-based strategy reflects more of an *emergent strategy by default* (Mintzberg & Waters, 1985). These networks are usually loosely structured without clear governance mechanisms, and the member firms are often still independent legal entities (Burawoy & Krotov, 1992; Filatotchev et al., 1992; Peng, 1993, 1994). In an uncertain environment, trust between network members may be easily exploited if there are divergent economic interests, especially when the enforcement regime is weak (Zucker, 1987). Therefore, the limits of the growth through a network-based strategy will be reached when the economic benefits yielded by previously underutilized resources are outweighed by the transaction costs of managing the additional bargaining and monitoring of member firms (Jones & Hill, 1988).

Applicability

How does the model we advance here pertain to the growth of the firm in the West? Given that for various reasons, Western firms have become increasingly interested in pursuing a network-based strategy of growth, at first glance one might suggest that, after all, the growth of the firm in formerly planned economies is not that different from its Western counterpart. We contend that, although forming interorganizational relationships (i.e., networks) is certainly one, and perhaps increasingly popular, way of doing business in the West, it represents the *most viable* way of doing business in planned economies in transition, where every rule is rapidly changing and the only constant is uncertainty. Because both generic expansion and acquisitions are problematic for firm growth at present, firms there frequently have to resort to a network-based strategy of growth because of the dominant logic inherited from old days. Such emergent strategy or strategic choice by default (Mintzberg & Waters, 1985) differentiates the firm in formerly planned economies from the typical Western firm. Moreover, the intensity and propensity of firms and their managers to engage in networking activities make them stand out to represent a distinct model of growth. The current institutional environment in these countries has dictated that a network-based strategy of growth to be the natural strategic choice.

Although the model we identify certainly pertains to the relationships between firms within each formerly planned economy, it is also applicable to the interorganizational relationships between firms in these countries and their Western counterparts. The active courtship for foreign investors and joint venture partners from the West should be interpreted as one facet of such a network-based strategy of growth at work (Peng, 1995; Staber & Aldrich, 1994). Firms in these countries seek to obtain financial, technical, as well as managerial assistance from their Western partners, while attempting to achieve their own growth through organizational learning efforts to assimilate the imported expertise (Elenkov, 1995; Puffer, 1992, 1994; Stross, 1990; Yan & Gray, 1994). With this motive, joint ventures are preferred as the better mode of entry by indigenous firms in these countries, compared with other modes of entry such as licensing or wholly owned subsidiaries.

Research Implications

For researchers interested in the diversity among organizations (e.g., Carroll, 1993; Hannan & Freeman, 1989; Lammers & Hickson, 1979), the proposed model of firm growth through boundary blurring offers ample opportunities for insight for a more complete theory of the growth of the firm. Because of the paucity of research on the topic, at present we know very little about, for example, the actual mechanism through which these firms manage to achieve growth; nor do we know the performance implications of different routes of growth within this general strategy (i.e., teaming with foreign firms, local firms, or government bureaucracies). Preliminary work by Burawoy and Krotov (1992), Carroll and colleagues (1988), Elankov (1995), Nee (1992), Tan and Litschert (1994), and Xin and Pearce (1994) explored the course of such growth in Russia, Hungary, and China. A more refined, theoretical approach to improve our understanding of the organizational dynamics in these local settings is warranted. At this stage, perhaps empirical efforts should be focused on qualitative field studies in these countries.

Furthermore, those interested in diversity in organizational forms can explore the internal structures of organizations that emerge in these economies (Carroll, 1993). Many organizational theorists have identified congruencies between internal structures and the external environment (Lawrence & Lorsch, 1969; Thompson, 1967); they also examined the changing structural conditions and life cycle changes of firms as firms grow (Greiner, 1972). These concepts should be explored within the setting of planned economies in transition to further develop our understanding of internal issues around firm growth.

Although we have focused on the effects that institutional frameworks have on the growth of the typical state-owned firm, North also identified the reciprocal impact that organizations wield on institutions over time (1990: 5). An interesting extension of this article would be to explore the impact of these network-based strategies on the formal and informal institutional structures of these countries, especially because some might argue that the current transition away from a planned economy will reduce the diversity between these and other market-based countries. Instead, as these institutions and organizations in these countries co-evolve, *more* diversity among these countries might be created because of this dynamic interaction between institutions and organizations.

Finally, how firms in different countries of this group differ in their strategies for growth will be an area worth exploring. The path-dependence nature of each country's development suggests that on top of the similarities we outlined above, the growth of the firm will certainly take on certain national or regional flavors. Comparative research (e.g., comparing Russia with the Ukraine, Eastern Europe with Western Europe, China with other East Asian countries) in this area should be undertaken to further our understanding of such phenomena.

In sum, it will be interesting to examine the ongoing changes in organizations and institutions in formerly planned economies. Of particular interest is whether the network-based strategy of growth will be a persistent pattern or will be phased out as more generic expansion and acquisition strategies are adopted under evolving institutional conditions.

Practical Implications

For public policymakers in planned economies, the most urgent task is to build institutions that strengthen the emerging strategic factor markets (Clarke, 1991; Fischer & Gelb, 1991; Litwack, 1991). Because the lack of a well-defined property rights-based legal framework prevents firms from mergers and acquisitions, the codification of exchange relationships to stabilize transactions for smooth ownership transfers is of paramount importance (North, 1990). For example, since 1979, China has promulgated more than 500 pieces of economic legislature, many of which are the first of their kind in the Chinese legal history, including Contract Law, Joint Venture Law, and Foreign Investment Law, among others (Clarke, 1991). Although still not adequate, the emerging legal infrastructure has greatly stabilized the transaction environment, fostered the infusion of foreign capital and technology into China, and encouraged a great deal of entrepreneurial activities (Shenkar, 1991; Stross, 1990). With the help from Western legal experts, the former Soviet republics and Eastern Europe are currently working hard toward that direction (Kornai, 1992; Spulber, 1991). These efforts should be applauded and strengthened.

On the other hand, increased efforts in modern management training is warranted. Without managers capable to function effectively in the context of markets, a growth strategy of generic expansion will be problematic. Given the lack of local expertise in these countries, Western management schools can play an active role in educating and training a new generation of managers (Puffer, 1992; Stross, 1990). Of course, it is critical that those attempting to educate these managers both understand the important constraints stemming from the local institutional frameworks and rethink concepts such as strategy, structure, and process to make certain that the concepts will be effective within those frameworks.

For managers in planned economies, it should be noted that, although efforts are being made to ensure that growth through internal expansion or acquisitions can take place more smoothly in the future, a network-based strategy of growth through boundary blurring will always remain a viable option for growth. Compared with markets and hierarchies, networks have some distinctive advantages in stabilizing economic exchanges (Powell, 1990). Moreover, networks serve as a direct link for entrepreneurs to notice and exploit opportunities as information flows derived from networks allow them to better predict and control their immediate environments (Butler & Hansen, 1991). Currently, these countries all need a class of entrepreneurs to bring initiative to their economies (McCarthy et al., 1993; Nee, 1992). Therefore, the entrepreneurial use of networks should not be discouraged, but instead strongly encouraged.

For Western firms seeking success in these new markets, efforts should be made to identify the relevant networks and their members. In other words, to understand the boundaries of the players in these countries where every boundary seems to be blurring is critically important (Peng, 1994, 1995). Western firms should first identify and select knowledgeable local managers and then rely on them to sail through the sea of network ties that characterizes planned economies in transition (Lawrence & Vlachoutsicos, 1993). It is also recommended that in such an unfamiliar environment Western firms take small steps before running, thus avoiding unrecoverable sunk costs should there be mistakes (Sharma, 1993; Stross, 1990). To expect that these new markets are supported by a familiar legal framework is unrealistic. Therefore, strategic attempts should be made to identify the relevant networks and to cultivate relationships with them.

CONCLUSION

We started the article by suggesting that, given the diversity of organizations operating in different institutional environments, a theory of the growth of the firm is not complete without taking the experience of firms in planned economies in transition into account. In the article a network-based strategy of growth through boundary blurring has been identified as a distinct model of growth for these firms. Under the constraints of a unique set of formal and informal institutional forces, these firms are able to achieve growth by pooling resources and coordinating activities among members of the network while avoiding the politically difficult task of ownership transfer. These networks, representing neither a market nor hierarchy form of organizing, enable firms in these countries to find a way to grow sustainably in a rapidly changing and tremendously uncertain time. In other words, these network-based organizational forms provide the necessary *adaptability* that is required in order to survive and prosper in the particular institutional frameworks that we have described (Hayek, 1945; Williamson, 1991). Moreover, this model also suggests that the growth of the firm is constrained by (a) its capability to have capable managers to articulate its organizational routines and transmit this information to its members and (b) its ability to overcome transaction costs incurred in the process of the growth. As such, this model also provides an understanding of its limitations.

Although we are not the first to point out the importance of network strategies in turbulent environments, this article does represent one of the first efforts to explicitly link the importance of network strategies with the institutional frameworks in a broad range of formerly planned economies. Previous authors in this area limited their attention to one country. In this article, we have moved beyond any single country setting and drawn implications from the common experience of firm growth across a broad range of formerly planned economies, thus greatly enriching the theory of the growth of the firm through such multinational triangulation efforts (Peng & Peterson, 1994).

In conclusion, planned economies in transition offer fascinating grounds to highlight diversity among organizations operating in different institutional environments. A better understanding of the organizational dynamics that shape such diversity will not only help managers in these countries improve the performance of their firms and help Western managers better deal with them, but will also greatly strengthen our field by incorporating such diversity in our theory-building efforts. As the field matures, the least we need now is the parochial thinking in mainstream organizational research (Boyacigiller & Adler, 1991). A complete theory of the growth of the firm has to take the experience of so many organizations in these countries into consideration.

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