



Small States: From caterpillars to butterflies (Part 2)

Joe Vella Bonnici

In the first part of our article, we argued that although today most states can be considered to be small, for historical reasons academic studies still look at small as being “sub-optimal” and reduced versions of the larger states which dominate the international political and economic order.

Moreover, there have been relatively few studies to assess and determine the sources for the competitive advantage of some small states. If we look at the enterprise level, we realise that there exist two main schools of thought that try to explain “superior performance”. The first of these schools builds on the Competitive or market power paradigm. This school is primarily represented by the work of Michael Porter through his “Five-forces model” and his “Diamond of National Competitiveness”. Cockburnⁱ (2000) says that Porter transformed the study of “imperfect competition” into the analysis of ‘competitive advantage’. In the process, Porter shifted “the focus of strategy research outward, towards the analysis of the firm’s microeconomic environment” (p 1126).

A successful firm enhances its “market power”, raises prices and creates higher “entry” barriers into the industry. This market power can, and does, shift over time. According to this school of thought superior performance is due to monopolistic rents resulting from privileged market positions.

A second school of thought which tries to explain “superior performance” is known as The Resource Base View (RBV). This “efficiency” paradigm has been extensively used in marketing, management, economics and business studies. Enterprises are seen as consisting of portfolios, or bundles, of distinctive and difficult-to-trade assets (‘resources’)ⁱⁱ which persist over timeⁱⁱⁱ. Firms achieve superior performance by developing and leveraging resources that are valuable, rare, inimitable and non-substitutable (VRIN)^{iv}.

The dynamic capability (DC) approach is another branch of RBV and seeks to incorporate dynamic and temporal elements (Teece et al.^v, 1997).

The emphasis is on developing and exploiting distinctive competences or capabilities not products or sectors. DC then supports growth and diversification that builds upon or extends existing capabilities

Dynamic capabilities can be disaggregated into the capacity to

- (1) sense and shape opportunities and threats,
- (2) seize opportunities, and
- (3) maintain competitiveness through enhancing, combining, protecting and reconfiguring the business enterprise’s intangible and tangible assets.

In a rapidly changing environment firms need to balance stability and integration (which are key to achieving efficiency) with flexibility and differentiation (which are key for adaptation and transformation). Operational effectiveness demands continuity, whereas dynamic capabilities emphasise “adaptation” and “innovation”.

The strategic alternatives (paths) available to the firm are determined by its existing socio-technical processes (routines) and are shaped by its resource and capability position. Teece et al (1997) state that “What the firm can do and where it can go are thus rather constrained by its positions and paths” (524).

Eisenhardt and Martin^{vi} (2000) argue that the strategic logic of dynamic capabilities has to be a combination of the leverage logic (enhancing existing resource configurations in the pursuit of long-term competitive advantage) with the opportunity logic (formulating new resource configurations in the pursuit of temporary advantages).

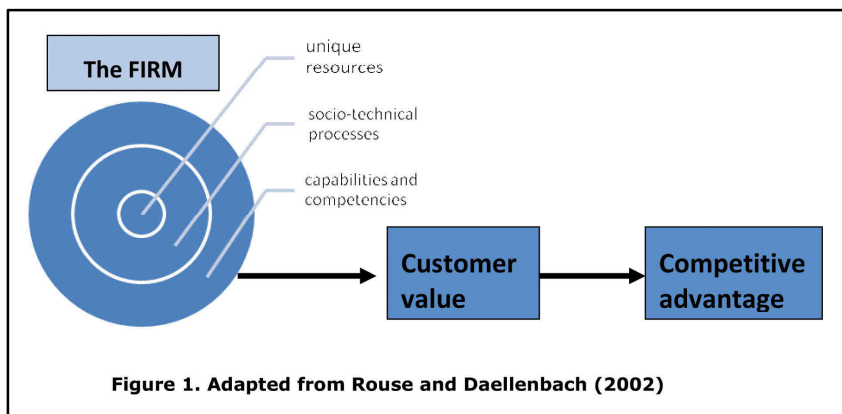
The efficiency and market power paradigms are often presented as being opposite to one another. Cockburn^{vii} et al (2000) challenge this perspective and argue that it “reflects a significant misconception, since the resource and the environmental perspective are complementary in many

but rather as the outcome of a “value chain” which brings together a number or a network of enterprises. Moreover, it is contended that that the value chain or network can draw upon resources and competencies arising out of its immediate environment be it a cluster, an economic sector or a region.

Although these “external” resources may also be available to local competitors it is how these resources are combined with “internal” ones that generates “uniqueness”. Following the same reasoning, it then follows that the cluster/sector/region can also draw from resources/competencies arising out of the “national” context. At this point competitiveness at the various levels is not seen in isolation but rather as part of a system. Domestic competition and international competitiveness are but facets of the same, dynamic process. We argue that such an approach can help our understanding of the dynamics of competitiveness within small states at the macro, meso and micro levels.

Flexibility is a critical feature for the survival of open systems (such as small states). Ashby^{ix} (1970) termed this the “law of requisite variety”. Jacobs^x (2005) holds that “To achieve strategic flexibility, organizations must embrace change as an inevitable and essential part of an organization’s growth. (4)

The concepts of flexibility and strategic flexibility appeared in



In Figure 1 we present a picture of the enterprise as seen from an RBV perspective. An enterprise that differs from others because it possesses unique resources and enjoys specific socio-technical processes which arise from its set of competencies and capabilities. It is this combination of elements that help the enterprise to create “value” to customers and is the basis for its competitive advantage.

important respects” (1127). Barney^{viii} (1991) points out that since the 1960s “the SWOT framework has been used to consider both external and internal phenomena in determining competitive advantage” (100).

Within the dynamic capabilities framework “small states” can be seen as “open units”. However, value creation in contemporary thinking is not seen as arising from within single enterprises

management literature in the 1950s. Johnson et al^{xi} (2003) state that “Since then studies on flexibility make a distinction between operational, tactical and strategic flexibility.” (75). Developing the “right” degree of strategic flexibility is of critical importance. Too much flexibility could jeopardise the company’s identity, competence building programme and longer term competitive advantage

Strategic flexibility is a dynamic capability in its own right as well as an outcome of other dynamic capabilities. Hulsman and Wycisk^{xii} (2008) state that “flexibility is not only to be seen as a competence of the system, but also as a mandatory condition for the system to eventually build competences.”(264)

“Strategic flexibility” can be applied at both the micro and the macro levels. Combe and Greenley (2004) add that “for strategic flexibility to exist at the level of the firm, decision makers themselves must possess capabilities for strategic flexibility.” (1458). Winter^{xiii} (2000) points out that it is not so much a question of whether or not decision makers possess capabilities such as strategic flexibility, but rather to what degree they possess them.

The “strategic flexibility” paradigm has been related to the superior performance of small states in the seminal work of Baldacchino and Bertram^{xiv} (2009). They build on the work of Katzenstein (1985 and 2003),

Brock (1988) and Carnegie (1982 and 1987) to argue that what successful small states have in common is “flexible, strategic responsiveness to threats and opportunities in their changing environments” (144).

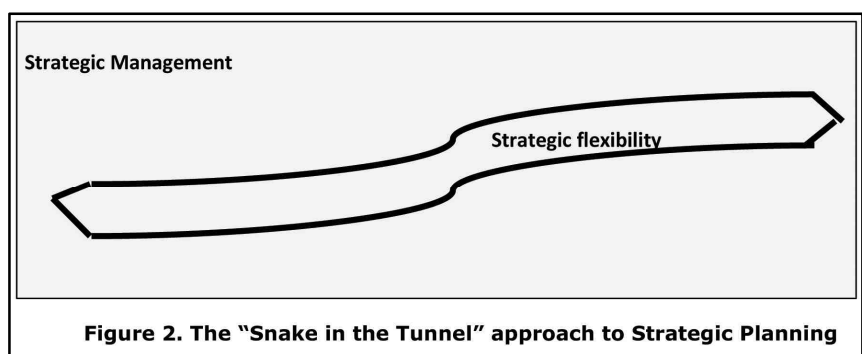
Baldacchino and Bertram (2009) point out that “individuals, households or business units strategically spread their risks, not in spite, but because of the small economy’s overall macro-dependence on one or a few, exogenous sources of income” (145). As a leading sector faces decline, despite resistance from social parties with vested interests, a small state switches to the next winning horse.

The “openness” of small state economies exposes them to changes arising from global markets. It is proposed to adopt a dynamic capabilities approach because we believe it is the most appropriate for the conditions faced by small economies

distant from core markets, makes it imperative that small states manage their interface with the outside world in a strategic and flexible way.

For a small state the dynamic capabilities framework highlights organisational and strategic managerial competences that enable some of its enterprises to achieve competitive advantage at home and overseas and how they morph so as to maintain it. The strategic options available depend primarily on their resource and capability base even in those instances when an opportunistic strategic logic is followed.

The strategic logic for small states should seek to combine the building and re-configuration of resources and competencies for long-term competitiveness (the tunnel) while exploiting the opportunities that arise for short-term gain(snake). This is shown in Figure 2.



It is postulated that “exogenous” environmental dynamism is of key importance in understanding the economic strategies (whether deliberate or emergent) adopted by small states. Having little market power, and at times being

The mere expansion of an economic activity could only lead to resource wastage and even lower productivity. Alternatively a small state may decide to diversify into another activity which involves a mere “re-configuration” of its resource

and competence base. Such diversification may initially result in an improved performance through marginally improved productivity levels. Diversification, unless matched by new competence building, will simply, over a longer period, maintain the same level of economic activity. This while competitors may be using the time to build new competencies to move ahead.

For economic development to occur, a small state needs to develop new competencies and capabilities that enable it to better exploit its existing or new resource-base. This will result in a “qualitative” leap in economic activity as shown in figure 3.

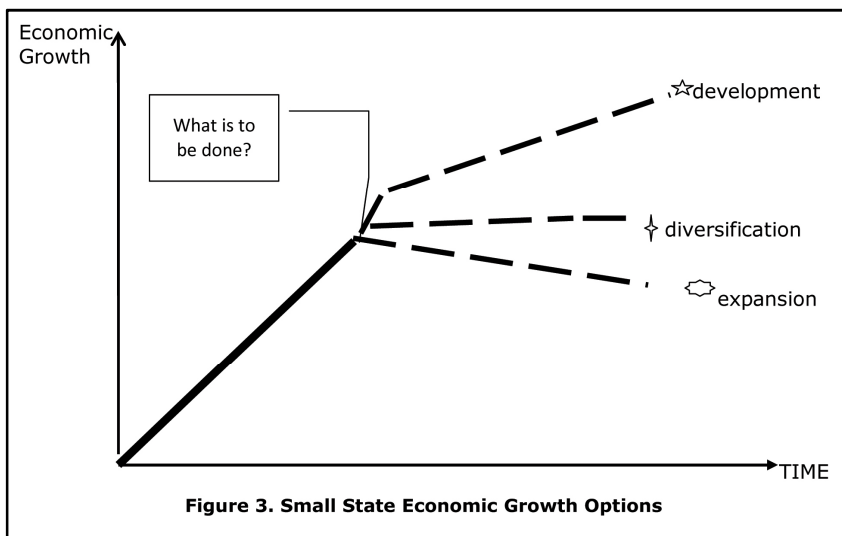


Figure 3. Small State Economic Growth Options

Baldacchino and Bertram (2009) remark that “Given the openness of small economies to events beyond their control, and the likely high impact of any such events on the domestic economy, one should not be surprised to find evidence of dynamism: particular economies mutate as their environments shift. (152)

The more dynamic the global market, the more flexible and the faster the response required of small states.

To identify the “right” opportunities requires a strong market orientation a clear vision and sense of direction. Market signals need to be interpreted correctly and the right resources and competencies mobilised at the right time and at the right pace. From a RBV perspective, there should be a close link between a small state’s resources and competencies and market opportunities.

It is postulated that small states have to re-define their concept or resources so as to include knowledge, strategic location,

jurisdiction, creativity, natural beauty, speed and any other resource that can contribute towards achieving competitive advantage

It can therefore be concluded that small states are different. Smallness carries certain characteristics: whether these become sources of strength or sources of weakness depends on

the strategic orientation of the small states themselves. The knowledge economy and globalisation is changing the scenario for small states. They have to develop a culture of “strategic flexibility” to exploit this change for their advantage. They need to adapt to emerging trends in their environment without losing track of their longer term vision and direction.

ⁱ Cockburn, I.M., Henderson, R.M. and Stern, S. (2000). Untangling the Origins of Competitive Advantage. *Strategic Management Journal* 21. 1123–1145

ⁱⁱ Teece, D.J. (2007) Explicating Dynamic Capabilities: The Nature and Microfoundations of (Sustainable) Enterprise Performance. *Strategic Management Journal* 28: 1319–1350

ⁱⁱⁱ Eisenhardt, K.M. and Martin, J.A. (2000) Dynamic Capabilities: what are they? *Strategic Management Journal* 21: 1105–1121

^{iv} Barney, J. (1991) Firm Resources and Sustained Competitive Advantage. *Journal of Management*, Vol. 17, No. 1, 99-120

^v Teece, D.J. Pisano, G and Shuen, A. (1997). Dynamic Capabilities and Strategic Management. *Strategic Management Journal*, Vol. 18:7, 509-533

^{vi} Eisenhardt, K.M. and Martin, J.A. (2000) Dynamic Capabilities: what are they? *Strategic Management Journal* 21: 1105–1121

^{vii} Cockburn, I.M., Henderson, R.M. and Stern, S. (2000). Untangling the Origins of Competitive Advantage. *Strategic Management Journal* 21. 1123–1145

^{viii} Barney, J. (2001). Firm Resources and Sustained Competitive Advantage. *Journal of Management*. Vol. 17 No 1. 99-120.

^{ix} Ashby, R.W. (1970). An introduction to cybernetics. London: Chapman and Hall Ltd

^x Jacobs, P. (2005). Five Steps to Thriving in Times of Uncertainty. *Harvard Management Update* December 2005. pp 3-5

^{xi} Johnson, J.L., Pui-Wan Lee, R., Saini, A. and Grohmann, B. (2003), “Market-focused strategic flexibility: conceptual advances and an integrative model”, *Journal of the Academy of Marketing Science*, Vol. 31, Winter, pp. 74-89.

^{xii} Hulsmann, M and Wycisk, C (2008). The role of Flexibility in Strategic Competence-Management –Contributions of the Concept of Self-Organization. *Research in Competence-Based Management*. Vol 4, 259–279

^{xiii} Winter, S. (2000), “The satisficing principle in capability learning”, *Strategic Management Journal*, Vol. 21, pp. 981-96.

^{xiv} Baldacchino, G. and Bertram, G. (2009). The Beak of the Finch: Insights into the Economic Development of Small Economies. *The Round Table* Vol. 98, No. 401, April. 141–160.