The Effect of Paradoxical Strategies on Firms' Positional Advantage and Performance: The Case of Indonesian Banking Industry

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Abstract: *Recently, researchers on strategic management have been concerned with the increasingly uncertainty, yet becoming more important, task environment that erodes firms' positional advantage more rapidly. As a result, firms are facing paradox of strategy, which demands rapid, yet accurate, strategic commitment in the present of strategic uncertainty. This empirical research addresses questions regarding how banks are best configured in facing environment with highly strategic uncertainty, while maintaining their positional advantage and performance. To test the proposed hypotheses, questionnaires were distributed to 122 top management teams of Indonesian commercial banks. In contrast with earlier research that environmental uncertainty has a positive, significant effect to Indonesian banks' strategic flexibility, this research found that environmental uncertainty does not have any significant effect to Indonesian banks' strategy. This research also showed that in order to increase their performance, Indonesian banks should allocate most of their efforts and resources on increasing their strategic flexibility before they put any efforts and resources on creating positional advantage and maintaining strategic consistency. In addition, if the Indonesian banks have an intention to increase their position in the industry, they should also allocate most of their efforts and resources on being strategically flexible.*

Keywords: *strategic uncertainty, paradoxical strategies, strategic flexibility, strategic consistency, positional advantage, firm performance*

1. Introduction

Strategic management research focuses on the relationships among environment, leadership and organization, strategy, and performance (Summer et al., 1990). Each of these constructs is multidimensional. Environment may be divided into task and general elements (Thompson, 1967). Similarly, leadership and organization encapsulate a variety of firm characteristics, including structure and culture (Summer et al., 1990). Strategy, on the other hand, can be viewed as composed of: process and content concerns (Ansoff, 1965); scope and resource deployments (Hofer and Schendel, 1978); or corporate, business, and functional-level issues (Andrews, 1971). Finally, performance consists of at least three categories, which are financial, operational, and overall effectiveness (Venkatraman and Ramanujam, 1986).

The central tenet in strategic management is that a match between environmental conditions and organizational capabilities and resources is critical to performance, and that is a strategist's job to find or create this match (Bourgeois III, 1985). Based on their focus on co-alignment with the environment, most strategies are built on specific beliefs about the future. According to Raynor (2007), this becomes a problem because: (1) the future is deeply unpredictable; and what makes it worse is that (2) the requirements of breakthrough success demand "strategic commitment", which defined as the implementation of strategy in ways that make it impossible to adapt should the future turn out differently than planned. The result is what he called the "strategy paradox": strategies with the greatest possibility of success also have the greatest possibility of failure. Further, according to him, the strategy paradox rests on two premises: commitments cannot be adapted should predictions prove incorrect; and predictions are never reliably or verifiably correct.

Having recorded a growth of 15.5% in asset value (Business Monitor International, 2013), the Indonesian banks have been vigorously competing in optimizing third-party funds from their customers, particularly in distributing credit. Nowadays, customers are inclined to be disloyal toward banks. In the consumer credit sector

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particularly, the best offering is valued based on the credit interest rate provided by banks. Consequently, banks should race against each other to lower their credit interest rate. However, the price war among players, in fact, makes customers even more disloyal. The competition in collecting third-party funds and in the credit sector have created a tendency of having more than one active savings account, or even credit card, among customers in the last couple of years. This phenomenon itself is a strong indication that customers nowadays tend to be disloyal and no longer want to be dependent on one bank only. Generally, customers have more than one savings account because they want separated accounts between savings and their routine transactions. Availability of transaction facilities, such as ATM and e-banking, is the key consideration for customers in selecting the accounts for their routine transactions. Meanwhile, the interest rates and fees become their major considerations on the selection of savings accounts.

This paper is organized as follows. The relevant theories and literatures related to the concept of paradoxical strategies are reviewed in the next section. Then, it is continued by the conceptual model and hypotheses to be tested. After that, it is followed by a report of the empirical setting, development of measurements, data analysis, and findings. And in the last section, the theoretical contributions, managerial implication, and opportunities for further researches are presented.

2. Literature Review

Strategic Uncertainty

Environments create both problems and opportunities for organizations. Organizations depend on the environment for scarce and valued resources, and organizations often must cope with unstable, unpredictable external events (Daft, Sormunen, and Parks, 1988). The environment was defined by Duncan (1972) as the relevant physical and social factors outside the boundary of an organization that are taken into consideration during organizational decision-making. Recent studies have conceptualized the environment as having several sectors that exist in two layers (Bourgeois, 1980; Dill, 1958; Daft, Sormunen, and Parks, 1988): (1) the task environment, defined as the layer closest to the organization, includes sectors that have direct transactions with the organization and have day-to-day influences to organizational operations and goal attainment; and (2) the general environment, defined as the outer layer, includes sectors that affect organizations indirectly. However, for a specific business firm, task versus general environment depends on how the firm’s domain is defined and how policy-makers choose to navigate the domain (Bourgeois III, 1980). In the banking industry the regulatory sector may be part of the task environment because of frequent transactions with government agencies (Daft, Sormunen, and Parks, 1988). Further, over a fairly lengthy period of time, technology developments have been the most important external drivers of banking industry (Jayawardhena and Foley, 2000).

Building on previous researches by Child (1972), Pfeffer and Salancik (1978), and Aldrich (1979), Dess and Beard (1984) identify dynamism, complexity, and munificence as the main characteristics of environmental uncertainty. They define dynamism as the level of turbulence or instability in the environment. As a result, in dynamic environments, managers are not able to determine the basis of their assumptions needed for decision making due to unpredictability of necessary information. For complexity, Dess and Beard (1984) define it as the diversity and concentration of resources in the environment. In a complex environment, the number of variables required by managers to make a decision increases. And regarding munificence, Dess and Beard (1984) define it as the relative level of existing resources. Hence, in low munificent environments, according to them, organizations are faced with intense competition since many organizations compete for the same low amount of resources.

Paradoxical Strategies

Previous research has shown that past organizational success leads to strategic consistency, which is a tendency for firms to stick with strategies that have worked in the past (Lant, Milliken, and Batra, 1992; Miller and Chen, 1994). Typically, such persistence is beneficial. Success goes to those who develop, refine, and enhance key competencies that lead to sustainable competitive advantage (March, 1991). However, major shifts in competitive, technological, social, and legal conditions may render prior strategies ineffective (Haveman, 1992; Smith and Grimm, 1987). To ensure alignment with the new environmental context, organizations must anticipate or detect such changes and initiate strategic transformations. As a result, managers face competing

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forces in developing successful strategies. On the one hand, it is easy to assume that a strategy that worked in the past will be the most effective strategy in the future (Prahalad and Bettis, 1986). On the other hand, however, managers are also exposed to forces driving toward strategic change (Kiesler and Sproull, 1982). Hamsal and Agung (2007) argued that these competing forces require organizations to implement paradoxical strategies in order to enhance and maintain their performance.

Paradoxical strategies are defined as the simultaneous implementation of strategic flexibility and strategic consistency in order to cope with environmental uncertainty and maintain performance at the same time (Hamsal and Agung, 2007). Strategic flexibility, according to Eppink (1978), is the flexibility necessary to compensate for strategic changes, which originates in the direct environment of the organization and reach it via the components of its direct environment. Aaker and Mascernhas (1984) and Bowman and Hurry (1993), on the other hand, conceptualize strategic flexibility as an option held by firms, which can be exercised in the event of an environmental contingency. They researchers argue that strategic flexibility can be increased by diversification, investment in underused resources, and reduction of specialized commitment. In contrast to flexibility, Lamberg, Tikkanen, and Nokelainen (2009) define strategic consistency as a firm's actions conjoin both with changes in the business environment, which necessitating adaptation and with the firm's own history (Zajac et al., 2000) and which necessitating continuity (Nelson and Winter, 1982).

Positional Advantage

A sustainable competitive advantage is the fundamental requirement for a firm to achieve superior organizational performance (Porter, 1985). A company can outperform rivals only if it can establish a strategic positioning, that is a difference that it can preserve (Porter, 1996). This difference is defined as a positional advantage, which refers to a low cost and/or differentiation advantage vis-à-vis competitors' (Porter, 1985). Thus, strategy is a means of locating an organization in unique positions relative to its rivals (Porter, 1996).

According to Besanko et al. (2010), a firm has a differentiation advantage when some value adding activities are performed in a unique way that leads to greater consumer surplus, which is perceived as superior along the benefits valued by customers. To convert a differentiation advantage into superior organizational performance, firms use their advantage to increase what the customer perceives as the product's total benefits. For these activities to be profitable, customers must be willing to pay a premium for the (perceived) benefits, and the premium must exceed the added cost of superior product performance (Porter, 1985). In contrast, Besanko et al. (2010) argue that producer surplus through efficiency is obtained by performing most activities in the value chain at a lower cost than competitors while offering a parity product. To convert a low cost advantage into superior organizational performance, firms pass their cost advantage on to customers by lowering what the customer perceives as the product's total acquisition and usage costs, while maintaining desirable profit margins (Narver and Slater, 1990).

Firm Performance

In strategic management literatures, firm performance is conceptualized in terms of financial performance or overall organizational effectiveness (Venkatraman and Ramanujam, 1986). According to organizational theorists, the overall organizational effectiveness is assessed only when it is viewed from multiple constituencies (Connolly, Conlon, and Deutsch, 1980) or stakeholders. In contrast, strategic management researchers restrict their measures of firm performance to financial indicators and other non-financial indicators that are related to the key success factors in their respective industry.

Emphasis on financial measures suggests primacy of financial goals. However, it may not represent the overall performance of an organization. A broader conceptualization of firm performance includes other operational non-financial indicators, such as market share, new product introduction, product quality, technological efficiency measures, and marketing effectiveness. Thus, measuring firm performance at both levels provides a better measure as it eliminates the dependence on measures that are either susceptible to manipulation or do not capture all the facets of business performance.

3. Conceptual Model and Hypotheses

This research enhances earlier researches on strategic flexibility, especially by Karri (2001) and Hamsal and Agung (2007) that assessed the relationship between strategic flexibility and firm performance relationship. In contrast to their researches, this research presents positional advantage as a mediating variable between the relationship of paradoxical strategies and firm's performance. The research conceptual model is presented in Figure 1 and the definition and operationalization of each latent variable is presented in Table 1.

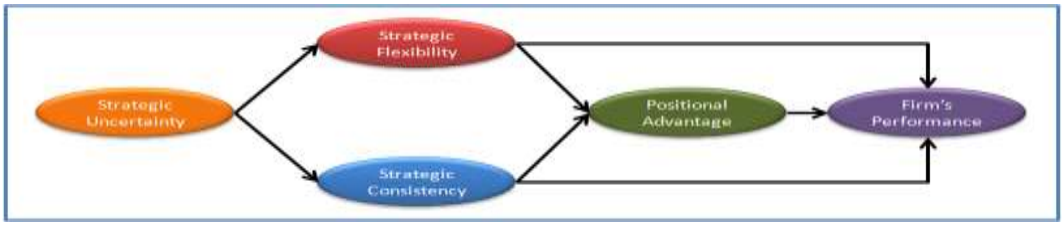

Fig. 1: Research Conceptual Model

TABLE I: Definition and Operationalization of Latent Variables

Construct	Conceptual Definition	Operational Definition	Dimensions & Indicators
SU	Sectors rate of change, complexity, and importance that expected to generate a need for policy-makers to scan events in that sectors (Daft, Sormunen, and Parks, 1988).	The degree to which managers perceive the complexity, rate of change, and importance of sectors directly related to the banking industry.	Dimensions = Complexity, Dynamism, and Importance. Indicators = 18. Source: Daft, Sormunen, & Parks (1988); Elenkov (1997); Hamsal & Agung (2007).
SF	An ability of a firm to initiate changes and to respond to changes in the industry (Karri, 2001, p: 62).	An ability of a bank to initiate changes and to respond to changes in the banking industry.	Dimensions = Proactive Flexibility and Reactive Flexibility. Indicators = 17. Source: Evans (1991); Karri (2001); Hamsal and Agung (2007).
SC	A tendency of a firm to maintain an initial successful strategy over an extended period of time (Hamsal and Agung, 2007).	A tendency of a bank to preserve its state of rest or uniform action over time.	Dimensions = Proactive Flexibility and Reactive Flexibility. Indicators = 12. Source: Parnell (1994); Hamsal and Agung (2007); Lamberg, Tikkanen, and Nokelainen (2009).
PA	A low cost and/or a differentiation advantage vis-à-vis competitor (Porter, 1991).	An ability of a bank to continuously creating superior value for its customers through a low cost and/or a differentiation strategies.	Dimensions = Differentiation Advantage and Cost Advantage. Indicators = 11. Source: Day and Wensley (1988); Porter (1996); Langerak (2003).
FP	A firm's effectiveness in accomplishing its major goals (Cameron and Whetten, 1983; Steers, 1975).	A bank effectiveness in accomplishing its strategic and financial goals.	Dimensions = Strategic Performance and Financial Performance. Indicators = 11. Source: Venkatraman and Ramanujam (1986), Karri (2001), and Hamsal and Agung (2007).

Based on the above conceptual model, this research will test ten hypotheses regarding conceptual relationships between strategic uncertainty, paradoxical strategies, positional advantage, and firm performance. Therefore:

H1: Positional advantage is positively correlated to firm performance (the higher the positional advantage of a firm, the higher the performance it has).

H2: Strategic flexibility is positively correlated to positional advantage (the higher the strategic flexibility of a firm, the higher the positional advantage it has).

H3: Strategic consistency is positively correlated to positional advantage (the higher the strategic consistency of a firm, the higher the positional advantage it has).

H4: Strategic uncertainty is positively correlated to strategic flexibility (the higher the perceived uncertainty and the importance of a sector, the more decision-makers are attempted to be flexible in their strategy).

H5: Strategic uncertainty is positively correlated to strategic consistency (the higher the perceived uncertainty and the importance of a sector, the more decision-makers are attempted to maintain consistency in their strategy).

H6: Strategic flexibility is positively correlated to firm performance (the higher the strategic flexibility of a firm, the higher the performance it has).

H7: Strategic consistency is positively correlated to firm performance (the higher the strategic consistency of a firm, the higher the performance it has).

4. Samples and Data Analysis

This research is a cross-sectional research among the Indonesian banking categories. According to Bank Indonesia (2013), there are two major groups of banking business: conventional banking, which includes commercial banks and rural credit banks, and sharia banking. As of June 2015, there were totally 122 commercial banks and sharia banks operating in Indonesia. The population of these banks is classified into state-owned banks (6), private national forex banks (35), private national non-forex banks (30), joint venture banks (15), foreign banks (10), and regional development banks (26).

After the questionnaire had been distributed, 66 were responded, resulting 55% response rate. Based on the type of ownership, these responded-samples are consisted of: (1) six state-owned companies (9.1% of the total samples); (2) twenty two private national forex banks (33.3% of the total samples); (3) fourteen private national non-forex banks (21.2% of the total samples); (4) nine regional development banks (13.6% of the total samples); (5) ten joint venture banks (15.2% of the total samples); and (6) five foreign banks (7.6% of the total samples).

The first hypothesis was tested using regression Model 1: $FP = \beta_0 + \beta_1 \cdot PA$. The result of regression analysis (Table 3) shows the empirical result of Model 1 as follows: $FP = 2.235 + 0.395 \cdot PA$. The second hypothesis was tested using regression Model 2: $PA = \beta_0 + \beta_1 \cdot SF$. The result of regression analysis (Table 3) shows the empirical result of Model 2 as follows: $PA = 2.057 + 0.554 \cdot SF$. The third hypothesis was tested using regression Model 3: $PA = \beta_0 + \beta_1 \cdot SC$. However, the result of regression analysis (Table 3) shows that Strategic Consistency (SC) does not have a significant effect on Positional Advantage (PA). The fourth hypothesis was tested using regression Model 4: $SF = \beta_0 + \beta_1 \cdot SU$. However, the result of regression analysis shows (Table 3) that Strategic Uncertainty (SU) does not have a significant effect on Strategic Flexibility (SF). The fifth hypothesis was tested using regression Model 5: $SC = \beta_0 + \beta_1 \cdot SU$. However, the result of regression analysis (Table 3) shows that Strategic Uncertainty (SU) does not have a significant effect on Strategic Consistency (SC).

The sixth hypothesis was tested using regression Model 6: $FP = \beta_0 + \beta_1 \cdot SF$. The result of regression analysis (Table 3) shows the empirical result of Model 6 as follows: $FP = 1.904 + 0.461 \cdot SF$. And finally, the seventh hypothesis was tested using regression Model 7: $FP = \beta_0 + \beta_1 \cdot SC$. The result of regression analysis (Table 3) shows the empirical result of Model 7 as follows: $FP = 0.725 \cdot SC$.

TABLE II: Result of Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations		
		B	Std. Error	Beta			Zero-order	Partial	Part
Model 1	(Constant)	2.235	0.866		2.583	0.012			
	Positional Advantage	0.395	0.184	0.279	2.151	0.036	0.279	0.279	0.279
Model 2	(Constant)	2.057	0.539		3.815	0.000			
	Strategic Flexibility	0.554	0.113	0.551	4.892	0.000	0.551	0.551	0.551
Model 3	(Constant)	3.242	1.182		2.743	0.008			
	Strategic Consistency	0.297	0.245	0.161	1.213	0.230	0.161	0.161	0.161
Model 4	(Constant)	3.462	0.673		5.148	0.000			
	Strategic Uncertainty	0.258	0.137	0.247	1.887	0.064	0.247	0.247	0.247
Model 5	(Constant)	5.148	0.376		13.68	0.000			
	Strategic Uncertainty	-0.069	0.076	-0.12	-0.9	0.373	-0.12	-0.12	-0.12
Model 6	(Constant)	1.904	0.867		2.196	0.032			
	Strategic Flexibility	0.461	0.182	0.323	2.532	0.014	0.323	0.323	0.323
Model 7	(Constant)	0.595	1.632		0.364	0.717			
	Strategic Consistency	0.725	0.338	0.277	2.141	0.037	0.277	0.277	0.277

5. Conclusion

First, this research confirmed that Indonesian banks are simultaneously implementing both of differentiation and cost leadership strategy in order to create superior value for their customers (Woodruff, 1988) while, at the same time, outperforming rivals (Porter, 1996). Hence, this research supports earlier finding by Slater (1997) that firms with a high degree of Positional Advantage, which is achieved by simultaneously implementing differentiation and cost leadership strategy, are rewarded with superior organizational performance relative to competitors.

Second, this research revealed that Indonesian banks' performance is mostly affected directly by their flexibility in strategy. Hence, Indonesian banks should allocate most of their efforts and resources on increasing their Strategic Flexibility before they put any efforts and resources on creating Positional Advantage and maintaining Strategic Consistency. Thus, this research supports earlier researches by Johnson, Pui-Wan, Saini, and Grohmann (2003), Matthyssens, Pauwels, and Vandenbempt (2005), and Zhang (2006) which acknowledged strategic flexibility as a critical organizational competence for achieving and maintaining competitive advantage and superior performance. On the other hand, this research also supports earlier research by Karri (2001) which confirmed that strategic flexibility helps firms to preempt competition, protect from environmental jolts, exploit available opportunities, and correct any damages that the organization might have suffered from the changes.

Third, this research found that Strategic Uncertainty does not have a significant effect on Indonesian banks' paradoxical strategies. Hence, this research does not support earlier research by Santos, Lopez, and Trespalacios (2012) which argued that turbulent business environment requires increasing organizational flexibility. In addition, this research also does not support earlier researches by March (1988), Meyer and Rowan (1977), Pfeffer and Salancik (1978), Miller and Chen (1996), and Teece, Pisano, and Shuen (1997) which argued that in the face of high uncertainty, organizations become committed to retain proven competencies. In contrast, this research supports earlier research by Paik (1991) which found that flexibility has a significant positive effect on business performance regardless of the environmental stability.

The second hypothesis revealed that organizations which possess strategic flexibility are in a better position to implement both cost leadership and differentiation strategies. This evidence supports earlier research by Santos, Lopez, and Trespalacios (2012) which found that strategic flexibility allows firms to avoid the trade-off between differentiation and cost leadership strategies, that is, in implementing a dual strategy if required. Therefore, in the present research, organizations that possess strategic flexibility can anticipate future changes in customer preferences, competitor movements, technology evolution, and economic tendencies, and reposition themselves in a timely fashion by reconfiguring their competences.

The third hypothesis revealed that Strategic Consistency has no significant relationship with Positional Advantage. Hence, this research does not support Nelson and Winter's (1982) earlier research which argued that consistent actions conducted by firms are: (1) the drivers of differentiation advantage, as these actions were created by an extensive bundle of resources, capabilities, and knowledge of "how things work"; and also (2) the drivers of cost advantage, as these actions increase the cumulative experience which allows firms to reduce the necessary amount of resources to expend to accomplish a task.

And fourth, this research identified that the highest value of Firm Performance can be achieved by a bank when its Strategic Flexibility has already become a distinctive Positional Advantage which also maintained by a strong basis of Strategic Consistensy. Thus, this research supports earlier researches by Day and Wensley (1988) which suggested that an organization's capabilities, which are complex bundles of skills deeply embedded in organizational routines, can lead to a positional advantage based upon innovative offerings or superior service.

6. Managerial Implication and Suggestions for Further Research

The evidence obtained in this research reveals that Indonesian banks can achieve high performance either by being consistent or by being flexible in their strategy. In the banking industry context, it means that any banks can be profitable by either being conventional banks or by being agile banks. However, each of the strategy has a different path in obtaining high performance.

A conventional bank generates its performance by: (1) exploiting its competencies that have proven valuable; (2) increasing efficiency, productivity, and quality through learning effects; (3) achieving short-run economies of scale through better capacity utilization; and (4) developing legitimacy with external stakeholders. However, driven by the natural tendency to continue exploiting previously effective strategies, conventional banks may: (1) ignore the creation of advantageous market position; and (2) ignore the implications of major environmental changes until drastic performance declines compel new strategies (Tushman and Romanelli, 1985). In contrast, an agile bank generates its performance by simultaneously implementing differentiation and cost leadership strategies.

In the domain of strategy paradox, this research did not deal with the process of managing the paradox itself. Instead, it only examines both of the context and content of the paradox. Hence, there is an opportunity for future researches to analyze how the paradoxical strategies are managed, and what the methods and the differences in their outcomes on firm's positional advantage and performance. Another opportunity for future research lies in the replications across different industries or different geographical regions. With these replications, the generalization of this research can be examined and proven.

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