Strategic management theory offers fresh take on the economic crisis

November 24 2009

The recent financial crisis and resulting global economic downturn has been the most defining global economic event since the Great Depression. Now research which appears in the November issue of *Strategic Organization*, published by SAGE, illustrates new ideas and philosophies in economics from strategic management, uncovering the micro-level underpinnings of the macro-level events we witness today.

Macroeconomics experts have used traditional theories to understand the causes of the economic crisis and offer new schemes and ideas for recovery. These discussions about fiscal and monetary policy dominated much of the conversation about the crisis and what to do about it, according to one of the authors Peter Klein, from the Division of Applied Social Sciences, University of Missouri.

Klein and his co-authors argue that macroeconomics is not equipped to offer full solutions to this crisis. Its basic assumption is that factors of production, firms, and industries in the economy are homogeneous and interchangeable. Research in strategic management has consistently shown that the assumption that the economy is made up of homogeneous or interchangeable factors of production is incorrect.

Strategic management theory—with its emphasis on heterogeneously distributed and rather immobile and inelastic resources and capabilities—is ready to open the debate to new ideas for the recovery.

The idea that resources, firms, and industries are different from each

other, that capital and labor are specialized for particular projects and activities, and that people (human capital), are distinct, is constantly encountered in strategic management theory and practice. That macroeconomic models assume factors of production in an economy are homogeneous is interesting, the authors point out, because this assumption creates problems for macroeconomics in both explaining the current crisis, and in deriving solutions.

The Bush Administration bailout and stimulus program in 2008 and continuing through the Obama Administration in 2009 represent a complex mixture of programs, designed to rescue failing banks, strengthen the financial sector, and appear to help homeowners. The same programs have been copied in the European Community throughout 2008.

The Obama Administration's American Recovery and Reinvestment Act included both stimulus and infrastructure spending. The latter was designed to target particular industries, regions, technologies, and business practices for government support and to provide incentives for particular kinds of business and consumer behavior (e.g., to invest in new "green industries". The EU plan copied this two-step approach on a smaller scale).

The article focuses on the macroeconomic stimulus itself, and—particularly in the US—the financial-sector bailout measures that followed. Treasury Secretary Henry Paulson told Congress in September 2008 that radical steps were needed "to avoid a continuing series of financial institution failures and frozen credit markets that threaten American families' financial well-being, the viability of businesses both small and large, and the very health of our economy."

The US government's restructuring plans for the financial and automobile industries, and potentially for other sectors are likely to run

into problems due to their basis in macroeconomic principles, the authors warn.

What should governments do during an economic downturn? The authors believe it is critical to avoid policies that generate poor investment in the first place. They argue strongly that basic heterogeneity of individuals, fiirms, industries, and regions cast doubt on the macroeconomic stimulus policies governments currently preach.

The authors discuss how just as strategic management theory has much to offer in understanding the crisis, the crisis has also thrown certain important weaknesses in current strategic management theory into sharp relief. Strategic management theory must extend its focus on heterogeneous capabilities to include the capabilities to handle major, anticipated shocks. Resourceful entrepreneurs and business managers urgently need us to do so, the authors state.

Adapting to external change is an important theme in strategic management research. Performance depends not only on resources and capabilities involved in production and market exchange, but also on the ability of business to influence political decision makers. In this climate, entrepreneurs may need to become skilled political lobbyists, taking advantage, and influencing the direction of the political debate.

Strategic management scholars have much to offer, and they must now engage in meaningful debate on how management theory can help resolve the current crisis, because the future, both immediate and long term, is at stake.

More information: Heterogeneous Resources and the Financial Crisis: Implications of Strategic Management Theory by Rajshree Agarwal, Jay B. Barney, Nicolai J. Foss and Peter G. Klein is published today in *Strategic Organization*, published by SAGE. The article will be free