VICTORIA UNIVERSITY OF WELLINGTON

GRADUATE SCHOOL OF BUSINESS AND GOVERNMENT MANAGEMENT

WORKING PAPER SERIES 5/93

National Renewal and Strategic Change - First lessons from an Early-Mover in Deregulation

Colin Campbell-Hunt *
David A. Harper **
Robert T. Hamilton ***

*	Management Group, Victoria University of Wellington
**	New Zealand Institute of Economic Research
***	Department of Management, University of Canterbury, Christchurch

May 1993

ISSN 0114 7420
ISBN 0 475 11463-9

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Colin Campbell-Hunt, David A. Harper and Robert T. Hamilton

Abstract

The scope and pace of economic liberalisation in New Zealand have been judged by the OECD as the most extensive of any undertaken in a developed economy during the past decade. This paper reports on a project aimed at determining how and at what rate New Zealand businesses have adapted to this major deregulation of their commercial environment. We first describe the nature of reform in New Zealand, and then we develop a qualitative model of the adjustment processes set in motion by deregulation. The process of strategic adaptation is represented as a continuum comprising four stages: stability, survival, sharpbending and sustained adaptation. This model is embellished with evidence on actual changes that have been observed in New Zealand business since deregulation. We conclude that, after eight years of substantial economic reform, the majority of businesses have not fully adapted to the new environment.

Keywords

Deregulation, strategic change, stages of adaptation (stability, survival, sharpbend, sustained adaptation)

Notes on the Authors

Dr Colin Campbell-Hunt
Senior Lecturer
Management Group
Victoria University of Wellington
PO Box 600
Wellington
New Zealand

Tel: 04 495 5066
Fax: 04 471 2200
Dr Campbell-Hunt is a Fellow of the New Zealand College of Management. His work has centred around the impact of deregulation in New Zealand.

Dr David Harper
Senior Research Economist
New Zealand Institute of Economic Research
PO Box 3479
Wellington
New Zealand

Tel: 04 472 1880
Fax: 04 472 1211
Dr Harper's research focuses upon entrepreneurship, structural change and the theory of the firm.

Dr Bob Hamilton
Associate Professor
Department of Management
University of Christchurch
Private Bag 4800
Christchurch
New Zealand

Tel: 03 364 2606
Fax: 03 364 2020
Dr Hamilton's main research interests are in the strategy and performance of firms and industries.

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Introduction

The objective of the project reported here was to determine how and at what rate New Zealand businesses had adapted to major deregulation of their commercial environment. The detailed work, commissioned and funded by the New Zealand government, was carried out towards the end of 1992, some 10 years after the onset of major economic deregulation (Campbell-Hunt et al 1993). We began by amalgamating the ideas from other studies of large-scale change into a new model of what we would expect to observe by way of strategic adjustment as a consequence of deregulation. Within this framework we then reviewed the available research bearing on the topic to confirm the structure of the model and build on it as complete a picture as possible of the actual adjustment of New Zealand businesses. Finally, we validated the descriptive accuracy of the resulting model by formally presenting and discussing it with around 100 senior executives drawn from all parts of the country. The next section outlines the nature of deregulation in New Zealand and is followed by a discussion of our qualitative model of the adjustment processes set in train by deregulation. We conclude with our best estimate of the rate of adjustment achieved by New Zealand business.

Deregulation in New Zealand

There is growing government and academic interest in how businesses respond to major deregulation, particularly as this affects the economies of Eastern Europe (Martin, 1992; Shama, 1993). However, such studies are limited to observing change as it happens and have not been able to offer a perspective of the whole change process. New Zealand business now has some 10 years of substantial deregulation behind it and may have some longitudinal lessons to share.

Prior to 1984, New Zealand's post-war governments have been highly interventionist by current OECD standards, putting in place an extensive regulatory regime involving import protection (quotas, licences, and tariffs) for the benefit of domestic producers; guaranteed minimum price levels for agricultural products; regulation of nominal interest rates and, at times, more widespread price level controls; restrictions on the buying of foreign currencies; and with the labour market controlled through a system of national industry awards and compulsory trade union membership. The performance of the economy declined steadily relative to others countries: in terms of GDP per head, New Zealand was ranked 8th highest in the world in 1955 but only 22nd in 1985. Regulation became discredited and the 1984 Labour Government embarked on a policy of rapid and widespread deregulation.

The scope and pace of the ensuing reform have been judged by the OECD as indeed the most extensive of any in the developed economies (OECD, 1990, p. 48-50). Early targets for deregulation were the foreign exchange and other financial markets. The larger task of industry deregulation is still continuing but the early moves removed quantitative controls on importing and began the reduction of border tariff levels. A laggard in deregulation was the labour market where the system of national industry-wide awards continued largely intact until the 1991 Employment Contracts Act substantially reduced the scope of collective bargaining and replaced it with individual or enterprise-level employment contracts. The ultimate objective of deregulation was to remove the bias and distortion that government intervention brings to price levels and, moreover, to expose businesses in New Zealand to much greater competition from imports. Time passed but the country's economic performance failed to show any sign of sustained recovery. Instead New Zealand slipped further in the OECD league table and the low rates of unemployment, which had been the jewel of the regulated economy, were now also swept into history: the unemployment rate of 10.3% of the labour force in 1991 contrasts with around only 0.6% in 1975. Towards the end of 1992, after some eight years of sustained deregulation and little evidence of economic gain from the process, critical scrutiny shifted to management in the private sector: how and at what rate were they adapting to the new rules?

A model of strategic adaptation to deregulation

The question with which we ended the previous section is essentially the one we sought to answer. Given the uniqueness of New Zealand's experience of deregulation, we had no other 'country models' to guide us. So, we constructed our own qualitative model of how we expected businesses to respond to deregulation by combining aspects from the works of Miles and Snow (1978), Miller (1987), Grinyer et al (1988), Doz and Prahalad (1987), and Pettigrew and Whipp (1991).

We are in effect asserting here that the response to deregulation can be represented as a continuum comprising four identifiable **STAGES**: stability, survival, 'sharpbending', and sustained adaptation. Each stage in turn can then be defined in terms of three **CONTEXTS**, as follows:

External: conditions in factor and product markets
degree of government intervention in markets
centralisation of economic decision-making
national cultural attitudes

Internal: belief systems within firms
distribution of power within firms
governance structures
firms' physical and human capital

Managerial: psychological and personality profiles
mental maps based on experiences
cultural backgrounds

Finally, within each stage there are four **ROLES** which senior managers must perform effectively in order to sustain each **STAGE** of the adaptation process. These **ROLES** we define as follows:

Strategic: shaping firms' responses to external threats and opportunities at both corporate and functional levels

Style-setting: deciding how to implement strategic responses through the social entity of an organisation

Directing: designing the organisation's structure, systems, and processes through which the organisation's activity is directed

Competency-building: adjusting the organisation's skills and competencies through recruitment and investment in physical, human, and intellectual capital

We would expect the importance of these different ROLES will vary across the STAGES of adjustment, with *strategy* being the most important in the early STAGES; *directing* and *competency-building* coming to the fore later; and *style-setting* being a high priority throughout.
A schematic of the model is presented in Table 1 within which we state, as specifically as we can, the particular CONTEXTS and ROLES we would expect to observe at each of the four stages. We now explain in more detail each of these STAGES.

TABLE ONE

	Stability	Survival	Sharpbending	Sustained adaptation
CONTEXTS				
External context	stable, munificent	dynamic, hostile	dynamic, hostile	dynamic, hostile
Internal context	values efficiency insensitive to change	belief system questioned changes to ownership and top management	belief system changed overcome power blocks	values adaptability innovation, learning
Managerial context	deep functional experience throughput competencies mastery of detail	sensitise firm to change	vision builders results oriented stamina, flexible conflict-tolerant	broad experience output competencies dynamic, learning
MANAGERS' ROLES				
Strategy	defenders, risk averse focus on known business	defend margins reduce debt contract to core business quality strategies	wide variety of strategies adopted	prospectors/analysers pro-active, risk-taking expansion strategies
Style-setting	directive styles		selling new vision directive possibly	participative styles
Direction systems	short-term planning functional structures	ultra short-term tighten structures and systems	transition from internal to external focus	strategic view of future market-based structures systems applied to ensure strategic change
Competency-building	external lobbying mastery of internal systems	systematic scanning	transition	capacity to sustain change in systems and people

STABILITY

The regime which gave protection from overseas competition and regulated much of the domestic economy was also able to deliver low rates of unemployment, at least through to the early 1980s. In this setting *external* CONTEXT for New Zealand business can be labelled as 'munificent' and 'stable', and with the *status quo* offering benefits to all, management would want to adopt a strategic posture which Miles and Snow (1978) would describe as 'defensive', ie., seeking to defend their established (and often protected) market position and react to change rather than strive aggressively to initiate change. Administrative and operational practices would have been those routines which had evolved over time as the most efficient, and experimentation likely to threaten established routines would be avoided: all in all a way of being which Mintzberg (1989) describes as the 'machine bureaucracy'. The structure of organisations will also be predicated on administrative efficiency and so will tend to be built around functional groupings. Managers will assume the role of the decision-makers and there will be little consultation with lesser staff. The most highly-valued competency will be the mastery of the systems through which static efficiencies are pursued, both technical and administrative. This in turn will put power and control in the hands of managers who have in-depth experience within particular functional specialisms. Major change would undermine this authority structure and so will be resisted.

SURVIVAL

Change came on a scale and at a rate which, following Miller and Friesen (1984), would require of businesses 'quantum' changes to long-held beliefs on strategy, structure, and systems. The agenda of change in the survival phase is conducted at two levels: the obvious one of short-term financial survival and the underlying agenda of changing a firm's long-held view of itself.

The conspicuous agenda of financial survival will include a priority on lowering unit costs. Overheads will be cut; administrative processes will be simplified; non-and core businesses will be divested. Manufacturers may be expected to integrate forward into the non-manufacturing (eg., distribution) in order to better protect their domestic profit margins. We would not expect to see much evidence of net new investment in people or things. The appropriate management roles in this period of some duress would stress the achievement of immediate results above all else. Decision-making style can be expected to be quite autocratic. But it was forcefully pointed out to us by managers who had come through all of this, that if they had allowed themselves to have been totally dominated by short-term financial imperatives, they would not have survived to tell their story. It is the deeper agenda of strategic reconsideration that is crucial to moving a business on towards a new and profitable future based on giving it a new view of itself.

This more fundamental strategic change is usually associated with large-scale changes in senior management personnel - the old power structure has to be overridden - and this is likely to follow a change in ownership and board composition (ie., governance structure). It is the completion of this process of strategic debate that becomes the key management challenge in the survival stage. Grinyer et al (1988) show that this period can be protracted, lasting in their sample of businesses from 2 to 10 years. Changing a belief system in an organisation is a bit like rebuilding a old bridge while many of its long-time satisfied users are still standing on it. It is at this point that many businesses fail. Five out of six failed turnarounds in Doz and Prahalad (1987) involved a failure by management to work their own way through the arguments of competing solutions to their strategic problems. This failure to work through to a new, shared view of how the business should be directed is fatal to the change process. Conversely, managements who are able to develop a new sustainable strategic direction will enable their business to apply its whole energy in the new direction, and succeed as a result (Hamel and Prahalad, 1989).

Key management roles in this task include that of building the organisation's sensitivity to the need to change. This can often involve a crisis, whether stage-managed or spontaneous. It also involves systematic analysis and reporting of trends in the environment and Grinyer and McKiernan (1990) stress the important role which this scanning activity plays in distinguishing their sharpbending businesses. But the dominant use of direction systems during this phase emphasises the monitoring and control of costs.

SHARPBENDING

Grinyer et al (1988) coined the term 'sharpbending' for the corporate experience of initiating a radically new strategy, once some such had evolved (from a survival phase). Up to this point in our story of the adjustment process, firms have been portrayed as facing similar strategic challenges and responding to them in one of a limited range of ways. However, the choice of strategy is not generic but very organisation-specific and it is at this point that businesses do begin to show their strategic individuality. The sharpbending phase is relatively short (a year or so), but dramatic and memorable to those involved. The development of a vivid and compelling vision of the future and being able to use this to excite the organisation are key aspects of the style-setting role at this time. Remaining power bases of the old order must now be overcome. Doz and Prahalad (1987) isolate shifts in power as one of the key phases in any process of strategic redirection with failure here being one facet of failed adaptations. However, they argue that the time to shift power is after changes to the belief system have been accepted and after the new strategy has been developed. Premature attempts to shift the power base are likely to be unsuccessful because the legitimacy for doing so had yet to be widely-established. The management role in this phase will be one calling for personal stamina, high tolerance for conflict, and flexibility.

SUSTAINED ADAPTATION

The task of bedding in the new strategy requires effort over a considerable period, 5 to 10 years in the sharpbenders discussed above (Grinyer et al, 1988). Pettigrew and Whipp (1991) set out the five areas in which management must remain active in order to sustain the energy for change and so avoid regression. These are:

Environmental assessment: requiring the creation (or acquisition) of competency in units such as marketing and planning

Commitment to change: an approach to leading change that avoids high profile dramatics and concentrates instead on building-up the organisation's commitment to ongoing change and to marshalling the resources and competencies required to effect continuing change

Linking strategic and operational change: through what we have called the directing role, establishing the new operating policies and the new systems for monitoring and rewarding behaviour. In contrast to the survival phase, the use of direction systems for sustained adaptation stresses the monitoring and control of market performance.

Investing in human resources: a philosophy which treats the human resources of the business as assets to be invested in rather than as a commodity to be traded

Maintaining coherence in the organisation: keeping the organisation open to change without reverting to old methods or to anarchy

Managing in this phase will call for considerable personal energy and creativity (to match that of the environment) and the charisma to also engage the energy and creativity of the staff. There is less need now for experience of the internal processes and systems which, in any case, will now be subject to ongoing change. Broader market experience is necessary coupled with the ability to read market directions and the vision to position the firm strategically for the future.

Tracking the New Zealand experience

We now move on to embellish this model of strategic adaptation with the evidence on the actual changes that have been observed in New Zealand business since deregulation. We focus here on changes in CONTEXTS (external, internal, and personal) and on ROLES (strategic, directing, style-setting, and competence-building), both being necessary to the dynamic of our model.

STABILITY

The evidence suggests that in style-setting roles, and in competencies, the typical New Zealand manager is still acting as if stability conditions prevailed.

Only one-in-three of current senior management rate themselves as competent in marketing, the lowest frequency of any competency area. By contrast, it is still those skills of Mintzberg's machine bureaucracy which are rated as adequate: financial management, accounting, and production and operations management (Hooley and Franko,1990). Objective comparisons suggest that these self-ratings may be optimistic. One-third of capital investment decisions taken in New Zealand in 1989 used DCF methods. Although this represents a doubling of use since 1979, it is only half the frequency observed in such decisions in the United States (Patterson, 1989).

As to tenure, one quarter of managers have been in their current jobs for over 11 years (Walker and Vitalis, 1992). For these managers at least, New Zealand organisations continue to value the accumulated knowledge and experience suitable to conditions of stability. In educational background, a survey of CEOs conducted in 1984 found that the majority (52%) had not progressed past minimum school-leaving qualifications (Hamilton et al, 1992). By 1991, this proportion had risen rapidly to 82% as a result of the high levels of turnover in top management positions. However, despite this improvement, the proportion of the 1991 CEOs who were university graduates was only 34% (cf 85% in Japan and the USA, and 60% in Germany and France).

It is still the case that New Zealand managers spend more time on the traditional functions of planning, control and decision-making (the tasks of the machine bureaucracy) than managers identified as effective in a comparable US study (O'Driscoll et al. 1991). The more people-oriented roles of motivation and staff development are the tasks which are most often cited for improvement, both by managers and their staff. Far from adopting the participative styles appropriate to sustained adaptation, two managers in three believe that management does not seek input from employees when at times that input would be valuable (Walker and Vitalis, 1992).

Some 8 to 10 years down the path to deregulation, the profile of management competence and style emerging from these results is still closest to that consistent with pre-deregulation conditions of stability.

SURVIVAL

Survival is the phase which most fully characterises the present state of New Zealand businesses. It best describes firms' internal context, and the strategy, direction system and competency-building roles of New Zealand managers.

The internal context has changed through large scale adjustments to firms' human and physical assets. Mergers, consolidations, internal reorganisations and plant closures have been among the most frequently used methods. Change has not been held up by rigidities in these assets: most industries have been able to match supply and demand with capacity utilisation remaining about the same in 1990 as it had been in 1985 (Baird et al, 1990). But there have been qualitative impediments to the reallocation of assets with one study (Savage and Bollard, 1990) reporting that the industry-specific capabilities of major assets had constrained managers to seek better quality/price combinations, and improvements in the productivity of assets, rather than accept large book losses on disposal.

Another sustained feature of corporate life in New Zealand since deregulation has been high rates of ownership change. Even before deregulation began in earnest, there were major shifts in governance structure. In 1974, owner-dominated boards were in place for only about one-third of listed companies, leaving two-thirds under the influence of the managers. By 1985, 85% of these boards were owner-dominated (Fox and Hamilton, forthcoming, 1994). More recently, a series of studies carried out at the New Zealand Institute for Economic Research has shown that over any five year period since deregulation, about half of firms surveyed experienced a significant change in ownership, between one-half and three-quarters of these to the extent that the control of the company changed hands. This turmoil in governance and top management is most consistent with the survival phase of adjustment. But it seems that the acquirers of firms have yet to add value to their acquisitions: recent empirical studies have been unable to find any significant difference either between the financial performance of firms with different control-types (Firth, 1992), or in the extent of diversification (Fox and Hamilton, forthcoming, 1994). On this evidence, changes in governance have yet to show the desired effect of taking firms out of the survival phase and into sharpbending.

In their strategic role also, managers have shown behaviour most consistent with the imperatives of survival. Recent work on trends in diversification and concentration suggests that manufacturers have retrenched the scope of their operations, reducing their involvement outside their primary industry from 28% of total employment in 1982 to 22% in 1988 (Hamilton, 1991). Competitive strategies have been dominated by the one strategy of quality (Corbett, 1990 and 1992), used by more than half of firms in the first five years after deregulation (Campbell et al, 1989). This emphasis on quality improvement replicates Grinyer's results in the UK for companies in the pre-sharpbend phase of renewal. In their financial strategies, manufacturers have shown a marked shift away from debt as a source of finance (which fell from 47% to 27% of total between 1985 and 1990) and towards retained earnings, which rose from 37% to 64% (Baird et al, 1990).

Marketing and HR strategies have also shown some response to the exigencies of the survival phase, but the degree of change here is appreciably less than for other functional strategies. Although pricing policies show signs of responding to increased competitive pressures (Durden and Kelly, 1992), only one-in-four firms have undertaken a complete redesign of their product or service, or initiated new marketing programmes or distribution arrangements (Campbell et al 1989). Changes in industrial relations policies have been limited until the recent introduction of the 1991 Employment Contracts Act. Since then, the system of national, multi-employer awards has all but disappeared. But employers have shown greater interest in using the new degrees of freedom to reduce or remove penal rates than to introduce incentive or performance payments (Heylen-Teesdale, 1992). And internal HR practices continue to stress employment, salary administration and planning functions ahead of productivity and participation strategies. In fact, use of these more developmental HR strategies has actually fallen since 1978 (Stablein and Geare, 1993). Plausibly, the slower response of marketing and HR strategies stems from managers' lower levels of competence in these areas, resulting from several decades of stability-management.

Furthermore, in the direction role New Zealand managers appear to be still responding to the survival phase of adaptation. Since deregulation, there has been sustained investment in computer based management information systems (Campbell et al, 1989) which have been aimed mainly at improving accounting and cash management systems (Baird et al, 1990). By contrast, systems oriented to monitoring external change, such as planning systems, are among the management practices to have improved least since deregulation (Harper and Malcolm, 1991).

The competency building role is also in an intermediate stage between stability and sharpbending. The need is recognised for improvement in the management of people, technology, risk, setting goals, ethics, strategy and marketing, but three-out-of-four managers acknowledge that they do not do enough training, and for over 90% of these the reason is simply the difficulty of getting away from work (Hooley and Franko, 1991). It seems that most managers are still in crisis mode, knowing what they need to do to invest in their future competencies, but too busy to find the time.

SHARPBENDING into SUSTAINED ADAPTATION

As we pointed out at the beginning, the purpose of deregulation in New Zealand was to create rapid and major change. Without such external pressure, nothing would have changed. We expect large-scale external change to lead to large-scale change in the internal context and there is some evidence that the belief systems of the leading export-oriented firms have changed, but they have only done so in the last two years or so. A 1989 survey of 60 small and medium sized exporting firms isolated seven Critical Success Factors underpinning their success: R&D/technology and innovation; quality (product, service, TQM); active investment; management style; market selection; strategic market orientation; personal contact (NZ Trade Development Board, 1990, p. 7). Another distinguishing feature of these firms was their systematic approach to being market-led: using wide-angle scanning; market research; formal marketing and business plans; a structure established for exporting; and a long-term view of the business. They were also reported to have high energy management; entrepreneurial leadership; and a participative style of doing things. In strategy, directing, style-setting, and competency-building, these firms were at least trying to manage for sustained adaptation. Follow-up interviews with these firms in late 1991 found that many of these 60 companies (in fact 56 survived) had overcome obstacles which had earlier prevented them from investing in offshore markets. This had taken them through a radical strategic reorientation (a sharpbend), but only during the last two years.

Recent studies have also identified sub-sets of larger businesses which do appear to be operating in the sustained adaptation stage. These studies have been concerned with different aspects of management but reveal the same set of practices and, in some cases we suspect, the same set of firms. Leading firms are more likely to base their competitive strategies on product differentiation, specialisation, flexible production ability, cost advantages, product range rather than the ubiquitous resort to quality. They are also investors in trained workforces and design skills (Corbett, 1992). These companies resemble most closely the emerging best-practice companies in countries such as Japan and Korea who are moving towards customisation, rapid design changes, and a high frequency of new product introduction as the basis for global competition.

Leaders in technology also exhibit the characteristics of being in sustained adaptation. One survey (Johnston, 1992) found a marked correlation between the contribution to current sales of products introduced in the last 2 years and export intensity with the majority of exporters attaining 100% of these sales from new products. Around 20% of the firms surveyed had a technology strategy and treated its cost as an investment rather than an expense. The firms involved were also distinguished by being more likely to be New Zealand-owned; being export oriented but with a significant domestic market share; and as heavy investors in planning and human resource development.

The most recent information on the evolution of business strategy (Corbett, 1992), offers the first suggestion that the manufacturing sector is beginning to move towards sustained adaptation. In his 1990 survey, 99% of respondents were aiming to either build or defend share in their current market. By 1992, the balance had begun to shift towards more expansive strategies of market expansion and product line expansion, changes which are concomitants of dynamic environment 'prospecting' strategies. But these surveys do also confirm that, as of 1992 and after eight years of substantial deregulation, the majority of New Zealand manufacturers had not attained sustained adaptation. We would hazard that most other sectors - finance being one exception - less exposed to international competition would almost certainly be no further advanced in their response to deregulation.

Conclusions

The response of New Zealand businesses to deregulation has not been uniform. The adoption of the most appropriate strategy (sustained adaptation) has only begun to be apparent in leading firms since 1990. The majority of businesses, around 80% in our view, have yet to fully adapt to the new deregulated environment. The advice we would give to governments and their advisers who anticipate a speedy response to deregulation is that they are likely to be disappointed. Change when it happens can be rapid but it does seem to take a long time to happen.

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