

## **Paradoxical Strategies and Firm Performance: The Case of Indonesian Banking Industry**

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*Recently, research on paradoxical strategies has been considered critical in winning in the competitive dynamic landscape, characterized by uncertainty and rapid changes in the business environment. Such environmental uncertainties require firm to apply paradoxical strategies; combining strategic flexibility and strategic consistency (Parnell, 1994). This study addresses three main questions: what is the effect of strategic flexibility on firm's performance; what is the effect of strategic consistency on firm's performance; what is the contingent effect of perceived environmental uncertainty on the relationship between paradoxical strategies and firm's performance. Questionnaires were distributed to 131 CEOs or members of top management team of Indonesian commercial banks (including sharia banks); and the 59 returned responses were analyzed to test hypotheses. The results indicate that strategic flexibility has positive effect on bank's performance, while strategic consistency does not have significant effect on bank's performance. In terms of combining these two paradoxical strategies, the results of this study confirm that the effect of strategic flexibility on bank's performance depends on strategic consistency and environmental uncertainty.*

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

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### **Introduction**

In the distance past, research on strategic management had been frequently under the assumption of stable environment with gradual change (Andersen, 2004; Mintzberg, 1973). Subsequently, the best strategy should be consistence and consonance, backed up by superior resources (Rumelt, 1980). In that context, prior to 1999, strategic flexibility had received very little attention in the literature of strategic management (Volberda, 1999).

However, the most recent literatures show that researchers have increasingly directed

their attention to the role of flexibility as a source of competitive advantage (Marcus, 2006). The basic reason is that the business environment is increasingly turbulence (Rigby and Rogers, 2000). Hence, winning in competition will rely more on speed and surprise (Pech and Slade, 2005). These flexible responses will ultimately affect positively on the performance of the firm (e.g., Abbott and Banerji, 2001; Karri, 2001).

In an information-intensive environment, banks face inevitably fast changes of the macroeconomic forces (Harker and Zenios, 2000); and broadly caused by highly political

turbulent environment (Henson and Wilson, 2002) due to globalization, deregulation, capital market pressures, innovative technology, new competitors, switching business models, and changing customer needs (Raynor, 2001a, 2001b). All of these changes have played a role in the erosion of product or service competitiveness in the banking industry, characterized by rapid geographic boundaries, restrictive government regulations, increased competition from non-traditional financial institutions, and sophisticated customers (Henson and Wilson, 2002).

This study investigates the paradoxical strategies namely strategic flexibility and strategic consistency deployed in the bank's strategy in dealing with environmental uncertainty and turbulence, and their impact on its performance.

The basic research question is "Does paradoxical strategies lead to higher bank performance?" For this study, paradoxical strategies are defined as a firm's simultaneous combination between implementing strategic flexibility adaptable to perceived environmental uncertainty, and strategic consistency for maintaining the initial successful strategy over an extended period of time.

This article is organized as follows. The next section begins by reviewing the relevant and extensive literature to identify the roots of paradoxical strategies. It continues by proposing a conceptual model and some empirical hypotheses to be tested. This is followed by a report of the empirical setting, development of measurements, data analysis, and findings. In the final section, the article suggests theoretical contributions, implications for practice, and further research.

## **Paradoxical Strategies and Environmental Uncertainty**

It is claimed that strategic flexibility is closely related to environmental uncertainty

(Abbott and Banerji, 2003; Raynor, 2007). As the external environment becomes more turbulence, banks need to develop greater flexibility that helps financial institutions guide their business going through uncertain changing environment. Strategic flexibility connotes with change and adaptation to maintain competitive strategy (Hatch and Zweig, 2001). According to Evans (1991) strategic flexibility is consisted of four dimensions and a number of corresponding "senses", i.e., pre-emptive moves (agility and versatility), exploitative moves (liquidity and elasticity), protective moves (robustness and hedging), and corrective moves (corrigibility and resilience). He argued that each of these dimensions and senses would be the relevant responses to environmental uncertainties or pressures.

Basically, the concept of strategy is rooted in stability (Mintzberg, 1973). However, increasingly many studies of strategy focus on change (Mintzberg, Ahlstrand, and Lampel, 2005), as indicated also that most of the management theory strongly emphasizes adaptation as an important capability for survival (Chakravarthy, 1982).

In essence, Ginsberg (1988) states that changes in the environment may increase choices, both pressure for change and not for change.

In term of resources to support the implementation of strategy, strategy researchers have emphasized stability in a firm's pattern of resource commitments (Sull, 2005). Through resource commitments, firms create entry barriers (Bain, 1956) and isolating mechanism (Lippman and Rumelt, 1982) that protect their competitive advantages. Such pattern of resource commitments can become impediments to strategic flexibility (Smith et al., 1997). This fundamental contrary situation of organizational change clearly shows that instead of changing the organization, organizational change is basically a reaction to strengthen the status quo (Molinsky, 1999; Tushman, 1997).

Figure 1. The Conceptual Model

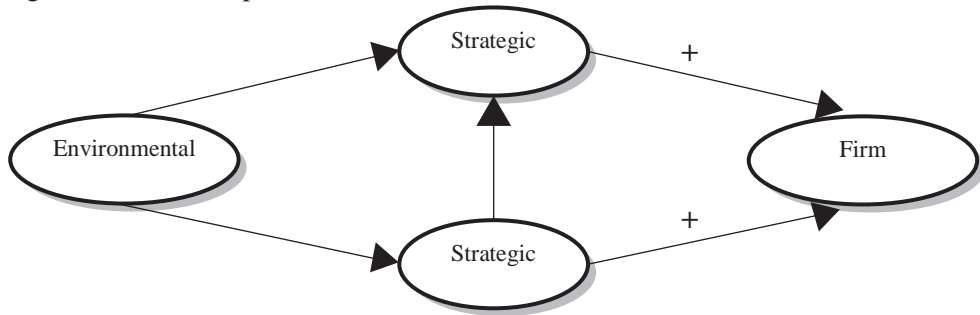


Table 1. Alternative Views on the Causes of Firm Performance

<b>Determinism</b>	<b>Contingency</b>	<b>Choice</b>
<i>Environmental selection</i>	<i>Fit to the environment</i>	<i>Selection the environment</i>
Performance determined by environmental circumstances	Performance results from organizational adaptation to environmental contingencies	Performance results from strategic management actions
<i>Sub-contributory theories</i>		
<b>I/O Economics</b> (Porter, 1980)	<b>Contingency Theory</b> (Lawrence and Lorsch, 1967)	<b>Strategic Choice</b> (Child, 1972)
<b>Population Ecology</b> (Hannan and Freeman, 1977)	<b>Emergent Strategies</b> (Mintzberg, 1994)	
<b>Institutional Theory</b> (DiMaggio and Powell, 1983)		
<b>More on Consistency</b> ← <b>Strategic Paradox Continuum</b> → <b>More on Flexibility</b>		

Source: Modified from Child, Chung, and Davies (2003)

Hence a firm’s strategy tends to be consistent with small variations.

Furthermore, bureaucracy in large organizations, firms with inflexible worldviews of managers, or incumbents with their previous success that limit their ability to react quickly, may prefer consistency or unaccommodative the needed flexibility to respond to fast changing environment (Clemons, 1997; Marcus, 2005).

Meanwhile, derived from Parnell (1994), strategic consistency is conceptualized into two strategic actions namely proactive consistency and reactive consistency.

Proactive consistency capabilities refer to a firm’s tendency to maintain initial strategies that had been successful in the past and being expected to be effective in the future. Reactive consistency capabilities denote a firm’s steadiness in its current strategic moves overtime due to too risky of being flexible.

The above two sets of situations flexibility and consistency make up the paradoxical strategies employed by firms to maintain viability in the changing environment (Parnell, 2005a, 2005b). Reputable consulting firm Pricewaterhouse Coopers has aptly specified paradox in five

principles, one of them is “positive change requires significant stability” (Price Waterhouse Change® Integration Team, 1996). In other words, to respond to environmental uncertainties and changes, an organization may choose to commit to initial strategy and/or remain strategically flexible to change and adapt. It was discovered that effective organizations maintain some balance or capability among these paradoxical strategies or combining strategic flexibility and consistency (e.g., Barnard, 1938; Cameron, 1986).

## Conceptual Model and Hypotheses

For this study, the proposed conceptual model of paradoxical strategies in dealing with the environmental uncertainty, and its effects on firm performance, is presented in Figure 1. This figure also shows the model that conjointly considers the hypotheses to be developed.

In developing the conceptual model of paradoxical strategies firm performance with perceived environmental uncertainty as antecedent, several related theories are presented in Table 1 as theoretical foundations. As can be seen from Table 1, the main theories on organization and environment relationships are classified into three groups of theories, namely Determinism, Contingency, and Choice. These theories also reflect some alternative views on organizational performance.

The Determinism views focuses mainly on the natural selection performance being determined by environmental circumstances and tends to formulate consistency in strategy process. The Choice views that performance results from action by managers and tends to choose flexibility in strategy process. The Contingency views that performance results from the extent to which there is adaptation to environmental changes a combination of

the two-group theories.

## Strategic Flexibility

Strategic flexibility is considered to have a major impact on the performance of the firms in turbulent and unpredictable environments (e.g., Ginn and Lee, 2006; Volberda, 1996). Early study on flexibility in manufacturing settings by Swamidass and Newel (1987) revealed statistical support for the linkage between flexibility and performance. Zhang, Vonderembse, and Lim (2003) found that volume flexibility and product mix flexibility had strong, positive, and direct relationships with customer satisfaction. However, Pagell and Krause (1999) found no evidence that higher levels of flexibility were linked to higher levels of performance. Yet, Verdú-Jover, Lloréns-Montes, and Garcia-Morales (2004) found that operational flexibility has a more positive influence on business performance in service firms than in the manufacturing sector. De Toni and Tonchia (2005) argue that there are linkages between operational and strategic flexibility. The notion of strategic flexibility takes into the ability organizations to not only adjust to environmental changes but also to influence these changes (Karri, 2001; Lengnick-Hall and Beck, 2005).

There are many empirical supports for a positive relationship between strategic flexibility and firm performance (e.g., Abbott and Banerji, 2003; Dreyer and Grønhaug, 2004; Ginn and Lee, 2006; Karri, 2001; Pesich, 2003). According to Evans (1991) strategic flexibility would be in response to some forms of external environmental uncertainties and he categorized this into preemptive, exploitative, protective, and corrective maneuvers. In other words, the impact of these strategic actions on firm performance under environmental uncertainty is hypothesized in this study on service industry, namely banking industry. Thus, it may be hypothesized that:

*H1: The greater a firm's strategic flexibility, the higher will be the level of firm's performance.*

## **Strategic Consistency**

Parnell (2003) questioned whether strategic consistency more important than strategic flexibility. He further added that a firm's strategic managers may choose to commit to a course of action for an extended period of time. Sull (2005) argues that consistency enables managers to achieve positive results. Harveston, et al. (1997) examined the relationship between strategic consistency and diversified firm performance from a resource-based perspective. Their study indicated negative relationship between strategic consistency and firm performance.

Brauer and Schmidt (2006) found that the overperforming firms are unsuccessful in preserving their strategic consistency at the same level over time. Research of Parnell (1994, 2005b) and Sriram and Anikeeff (1995), however, found that there is a strong link between strategic consistency and superior firm performance. Hence, it may be hypothesized that:

*H2: The greater a firm's strategic consistency the higher will be the level of firm's performance.*

## **Combination Strategy**

Some challenges faced by the firms in respect to the environmental uncertainty can be explaining and articulating through the strategic choices being made and the link between those choices, environments, and firm performance (Davies and Walters, 2004). Recent research has extended the "combination strategy" perspective both conceptually (e.g., Fuchs et al., 2000; Lowson, 2003) and empirically (e.g., Parnell and Hershey, 2005) to suggest that a combination strategy (simultaneously between strategic

consistency and flexibility) is associated with superior business performance (e.g., Parnell, et al., 2000). In this case, paradoxical strategies are also considered as a combination strategy (Parnell, 2005a).

Research conducted by Lloréns, Molina, and Verdú (2005) in manufacturing settings showed that there were interrelationships between environment, financial resources, manufacturing flexibility, and learning capacity, and these variables contributed to performance. Even though there has been no empirical study found in the combination between environment, strategic consistency, and performance, Anand and Ward's (2004) study shows that there is a need for fit between environment and strategic flexibility, and such fit determines firm performance.

Barnard (1938) argued that the survival of an organization depends on the maintenance of equilibrium or readjustment of internal processes of the organization for dealing with continuously changing environment. Thus, in a similar vein, strategies should be more flexible when environmental uncertainty is greater; and as environmental uncertainty decreases larger consistencies can be chosen (Schoemaker, 2002). Therefore, combined hypotheses between strategic flexibility, strategic consistency, and firm performance with regard to environmental uncertainty can be explored. Hence, the following hypothesis is proposed:

*H3: The effect of strategic flexibility on firm's performance depends on strategic consistency and environmental uncertainty.*

## **Research Methods**

This study is a cross-sectional industry research among banking categories conducted in a field setting in Indonesia's banking industry. This industry is characterized by fast globalization influence, rapid consolidation, intense competition, converging toward each other, significant

falling market share, and technology revolution (Rose and Hudgins, 2005). As a consequence, this industry has also experienced and will continue to experience considerable pressures to adapt, innovate, act fast, and reduce costs due to fundamental shifts in its external environments.

Bank Indonesia supervises two major groups of banking business, i.e., conventional banking (consists of commercial banks and rural credit banks) and sharia banking. As of December 2005, there were totally 131 commercial banks (including sharia banks) operating in Indonesia. The research setting for this study is only comprised of commercial banks and sharia banks. The population of the banks is classified into state-owned banks (5), private national forex banks (34), private national non-forex banks (36), joint venture banks (19), foreign banks (19), and regional development banks (26).

In the survey of this study, subjective measures of environmental uncertainty, strategic flexibility, strategic consistency, and firm performance were collected from the bank key informants, i.e., CEOs or members of top management team through the mail survey. Questionnaire survey by mail is better suited for this study than telephone interviews due to the large amount and detail information being collected (Dillman, 1978).

In this study, multi-item scales were used to collect data on most of the key constructs. Simplicity in scoring was sought by using a balanced six-point Lykert-type scale that is easy to master. Basically, each respondent was asked to indicate the extent to which he/she disagreed or agreed with the given statement, such that 1 = strongly disagree and 6 = strongly agree. The dependent variable: "Firm Performance" and the key independent variables: "Environmental Uncertainty", "Strategic Flexibility", and "Strategic Consistency" (see Appendix A). The conceptual model previously presented in Figure 1 suggests that by considering certain environmental uncertainty then the

central concepts strategic flexibility and strategic consistency influence firm performance.

Environmental uncertainty is operationalized in three basic components, i.e., munificence, dynamism, and complexity. For this study, the measurement items used to capture the perceived environment include fifteen items that are grouped into these three components (five items each). This study uses the measurement items of Lukas, et al. (2001) scale of environmental uncertainty, which both derived from Dess and Beard (1984) and Duncan (1972). The measurement instrument of Lukas, et al. (2001) is relatively new, suitable for transition economies, and involves broaden stakeholders (including governmental role that are crucial for banking industry). This survey instrument asks respondents to rate the level of the outside factors features in terms of competitor, customer, supplier, technology, and regulation and policy.

Strategic flexibility is operationalized in four dimensions namely, i.e., pre-emptive moves, exploitative moves, protective moves, and corrective moves. This study adopts Evans' (1991) framework due to it holistically helps in developing an understanding of the multidimensional natures of strategic flexibility. In Karri's (2001) research, the strategic flexibility dimensions have been also adapted from the conceptual model proposed by Evans (1991). Note that only Karri (2001) who developed and applied strategic flexibility measures at the corporate/strategic level.

Strategic consistency is operationalized in two dimensions, namely proactive consistency and reactive consistency. Unlike Karri's (2001) instrument of strategic flexibility, the instrument of Parnell (2005b) that consists of four items, is not classified further into component/dimension. In this study, those original items of Parnell's (2005b) are enlarged by including four more additional items that developed from other researches such as Audia, et al. (2000), Barnett and Pratt (2000), Miller and Chen (2000), and



Molinsky (1999).

Firm Performance is operationalized in financial performance and strategic performance that is measured in terms of non-financial indicators. This study uses the performance criteria of Hooley et al. (2005) which further modified and added to suit for all perspectives of the Balanced Scorecard (Kaplan and Norton, 1992). Based on this subjective measures and confidentiality issues from the responded banks, the usual indicators of a bank's health in terms of CAMEL are not considered. Note that due to paradoxical strategies are a source of sustainable competitive advantage, in this study overall firm performance is preferably assessed based on comparison to closed competitors.

Table 2 summarizes the definitions of all four latent variables measured in this study, their operationalization, and the corresponding support in the literatures.

For each targeted bank the key informant of this study is the CEO of the bank and in some cases one of top management team who is familiar with strategic flexibility and strategic consistency matters. Subjective measures of perceived environment, strategic flexibility, strategic consistency, and firm performance are collected from CEOs and members of top management team of the banks through mailed survey.

After mailing the questionnaires, a week later, a follow up letter with a questionnaire was sent to the respondents as a reminder. Given the research context of commercial banks for this study, it is critical to accelerate and increase responses through mail and phone reminder system both from the researcher and corresponding banking associations. This resulted in total of 59 returned questionnaire, as response rate of 45%.

The responded banks consist of state-owned bank (8.5%); private national forex bank (33.9%); private national non-forex bank (33.9%); regional development bank (18.6%); foreign bank (3.4%), and joint venture bank (1.7%). Thus, the samples of

this study mainly capture private national banks with around 68% of total respondents. Looking at the status of the responded banks, there are 25.4% banks that "go public" and the rest (74.6%) are privately held companies.

## Data Analysis

### *Bivariate Correlation Analysis*

Please note that bivariate correlation analysis (X, Y) can be applied to examine the linear effect of X on Y (see Appendix B). In this study, bivariate correlation analysis is used between the four latent variables, i.e., environmental uncertainty, strategic flexibility, strategic consistency, and firm performance. The results are presented in Table 3.

Based on the results in Table 3, the following notes and conclusions are presented:

- Strategic Flexibility has a significant positive effect on Firm Performance. Hence, the data supports H1.
- Strategic Consistency has a significant positive effect on Strategic Flexibility but it has insignificant positive effect on Firm Performance. Hence, the data does not support H2.
- Environmental Uncertainty has a significant positive effect on Strategic Flexibility but it has insignificant positive effect on Strategic Consistency.

### **Multiple Regression Analysis**

In order to test H3, the hypothesis of the effect of Strategic Flexibility ( $X_1$ ) on Firm Performance ( $Y$ ) depends on Strategic Consistency ( $X_2$ ) and Environmental Uncertainty ( $X_3$ ), the following general regression model should be considered:

$$Y = f(X_2, X_3) + g(X_2, X_3)X_1 + \dots$$

where:  $f(X_2, X_3)$  and  $g(X_2, X_3)$  could be any function defined or proposed based on personal judgment. However, the following

specific regression model which is a model having three-way interaction factors is considered.

$$Y = (\beta_0 + \beta_1X_2 + \beta_2X_3 + \beta_3X_2*X_3) + (\beta_4 + \beta_5X_2 + \beta_6X_3 + \beta_7X_2*X_3)*X_1 + \dots \quad (1)$$

Please note that in two-dimensional coordinate system using  $X_1$  and  $Y$  as axes, this regression will present a set of lines with intercepts and slopes depend on  $(\beta_0 + \beta_1X_2 + \beta_2X_3 + \beta_3X_2*X_3)$  and  $(\beta_4 + \beta_5X_2 + \beta_6X_3 + \beta_7X_2*X_3)$  respectively.

In order to apply Model 1, the bivariate correlation between all variables used in the model is examined. The result is presented in Table 4. Note that Table 4 shows that almost all pairs of the independent variables have significant positive correlation at the 0.01 level (one-tailed). This result also indicates that there exists a high

multicollinearity between the independent variables.

Based on these results, it can be concluded that not all independent variables should be used as predictors of the dependent variable.

Then, by doing experimentation using procedures proposed in Agung (2004: 166-169), the following summary of statistical results presented in Table 5 is obtained based on an acceptable model in statistical sense.

Based on this table, the following notes and conclusions are presented:

1. Even though pairs of independent variable have significant bivariate coefficient correlation as presented in Table 4, it is found that the VIF value of each independent variable is less than 3.0. This model can be considered as an

Table 2. Definition and Operationalization of Variables

Variable	Definition	Operationalization	Support in the Literature
Strategic Flexibility	A set of bank capabilities used to respond to various changes in the external environment	A twenty one item asking top executive to agree or disagree to statements that characterize their bank's actions, such as pre-emptive, exploitative, protective, and corrective moves	Karri (2001) based on conceptual frameworks of Evans (1991)
Strategic Consistency	Bank maintains an initial successful strategy over an extended period of time	A eight item asking top executive to agree or disagree to statements that characterize their bank's consistency, such as proactive consistency and reactive consistency	Four items are originally adapted from Parnell (1994, 2005b); additional new four items are based on Audia, Locke, and Smith (2000); Barnett and Pratt (2000); Miller and Chen (1994); and Molinsky (1999)
Environmental Uncertainty	Degree of various environmental changes and uncertainty that faced by the bank	A fifteen item measuring top executive's perception of the changes in munificence, dynamism, and complexity.	Lukas, Tan and Hult (2001) based on Dess and Beard (1984) and Duncan (1972)
Firm Performance	Financial and strategic performance indicators of the bank	A fifteen item measuring top executive's perception on ROE, ROA, revenues, etc. and other non-financial measures relative to the bank's main competitors.	Hooley et al. (2005); Kaplan and Norton (1992); Venkatraman and Ramanujam (1986)



Table 3. Matrix of Bivariate Correlations

	Environmental Uncertainty	Firm Performance	Strategic Consistency	Strategic Flexibility
Environmental Uncertainty	1.000			
Firm Performance	0.085	1.000		
Strategic Consistency	0.088	0.080	1.000	
Strategic Flexibility	0.225*	0.688**	0.401*	1.000

\*\* Correlation is significant at the 0.01 level (1-tailed)

\* Correlation is significant at the 0.05 level (1-tailed)

Table 4. Matrix of Bivariate Correlations

	Y	X <sub>1</sub>	X <sub>2</sub>	X <sub>3</sub>	X <sub>12</sub>	X <sub>13</sub>	X <sub>23</sub>	X <sub>123</sub>
Y	1.000							
X <sub>1</sub>	0.688**	1.000						
X <sub>2</sub>	0.080	0.401**	1.000					
X <sub>3</sub>	0.085	0.225*	0.088	1.000				
X <sub>12</sub>	0.468**	0.833**	0.825**	0.183	1.000			
X <sub>13</sub>	0.493	0.781**	0.303**	0.772**	0.642**	1.000		
X <sub>23</sub>	0.129	0.418**	0.709**	0.755**	0.664**	0.743**	1.000	
X <sub>123</sub>	0.423**	0.767**	0.670**	0.630**	0.863**	0.899**	0.890**	1.000

\*\* Correlation is significant at the 0.01 level (1-tailed)

\* Correlation is significant at the 0.05 level (1-tailed)

Table 5. Summary of Statistical Results

Variable	B	t	Sig	VIF
(Constant)	-1.241	-3.506	0.001	
X <sub>2</sub> *X <sub>3</sub>	-0.098	-4.749	0.000	2.570
X <sub>1</sub> *X <sub>2</sub>	0.057	3.635	0.001	1.961
X <sub>1</sub> *X <sub>3</sub>	0.089	4.804	0.000	2.446

acceptable model in statistical sense.

- The regression function can be presented as:  
 $\hat{Y} = (-1.241 - 0.098X_2 * X_3) + (0.057X_2 + 0.089X_3)X_1$
- In two-dimensional coordinate system using X<sub>1</sub> and Y as axes, this regression function presents a set of lines with

intercepts  $f(X_2, X_3) = -1.241 - 0.098X_2 * X_3$  and slopes  $g(X_2, X_3) = (0.057X_2 + 0.089X_3)$ .

- The effect of Strategic Flexibility (X<sub>1</sub>) on Firm Performance (Y) significantly depends on Strategic Consistency (X<sub>2</sub>) and Environmental Uncertainty (X<sub>3</sub>).

## Findings and Discussion

As previously analyzed, the designated statistical analysis to test the first hypothesis of this study suggests that strategic flexibility has significant positive effect on firm performance. This finding is supportive of existing researches which studied the impacts of strategic flexibility on firm performance both conceptually (e.g., Das and Elango, 1995) and empirically (e.g., Abbott and Banerji, 2003; Ginn and Lee, 2006; Karri, 2001; Pesich, 2003). To increase their performance, banks need to apply flexible strategies. In banking world, the key of these capabilities include responsiveness in operations, understanding the importance of time-based competition in responding to customer needs and expectations, ability to change capacity rapidly and improve customer accessibility, ability to introduce products/services quickly, and ability to match products/services to customer satisfaction effectively (Roth and van der Velde, 1991).

It is claimed that great firms successfully managed different innovation streams over time: processes for incremental, architectural, and radical innovations which requires an ambidexterous organization (Tushman, 1997). These streams of innovation allow them to enter new markets with existing products and to proactively introduce substitute products that can create new markets and establish new standards and rules for the industry (Ansoff, 1965). The ambidexterous firm can do two contradictory actions simultaneously and did well. In this firm, managers "maintain consistency and encourage continuous improvement in current offerings, while at the same time allowing the flexibility and experimentation that help the firm create or respond to radical shifts in the environment" (Tushman, 1997: 17). The results from this study indicate that the participated banks in each firm performance category maintain some balance of capabilities between strategic flexibility and consistency. This finding

among others is supportive of both Barnard's (1938) and Cameron's (1986) theory on balancing these paradoxical strategies. Some banks prefer consistency or being conservative banks, others involve in flexibility or being agile banks. Those flexible moves undertaken by the banks have positive effects on each category of firm performance.

In examining the direct effect of strategic consistency on firm performance, the designated statistical analysis indicates that strategic consistency has insignificant positive effect on firm performance. Unlike Parnell's (1994, 2005b) research, this finding is therefore supportive of Harveston, et al. (1997) research on diversification from a resource-based perspective.

Furthermore, it is believed that two fundamental strategy perspectives of planning or emergent action have often been considered as either/or choices contingent on environmental conditions, where strategic emergence was seen as appropriate in turbulent environments while strategic planning applied to stable and predictable conditions (Mintzberg, 1973; Powell, 1992). Nevertheless, data collected from this study supports the hypothesized combination that the effects of strategic flexibility on firm performance depends on strategic consistency and/or perceived environment.

Two comments can be elaborated based on these findings. First, the findings are supportive the paradox principle that positive change or flexibility needs significant stability or consistency (Price Waterhouse Change® Integration Team, 1996). Second, these findings also support the strategic choice view proposed by Child (1972) who argues that firms which are able to exert influence and shape the environment would experience positive performance outcomes. Thus, results from the study indicate that a bank accommodates strategic consistency only as a basis or reference to apply strategic flexibility in responding to environmental uncertainty and turbulence. As an illustration,

today's banking service delivery systems comprise not only physical branches but also remote or virtual channels such as ATMs, call centers, mobile and the Internet. To locate new ATM booths as well as offer financial services to customers in remote cities/areas where there are no bank's branches, first, banks need to know in which areas their existing physical outlets located to avoid redundancy. Second, banks need to understand how their physical outlets fit with these other channels (Bekier, et al., 2000).

In general, the findings of this study imply that strategic flexibility is an extremely important determinant of firm performance. To develop strategic flexibility capabilities within a firm, it surely needs to consider and anticipate environmental uncertainty and turbulence as the antecedent. However, the findings in this study show that the various levels of perceived environment do not have significant different for strategic flexibility.

While, from previous analysis, the findings indicate that the means of strategic flexibility do not have significant differences between bank's capital categories for all categories of perceived environment level. In banking industry, over a fairly lengthy period of time, regulations and technology developments have been the most important external drivers (Jayawardhena and Foley, 2000). Howcroft (2005) argued that banks which had a predominantly inward-looking focus began to shift more on outward-looking focus (flexibility) characterized by market concerns drive the organization emphasis on quality, customer service, segmentation, and retention.

## Theoretical Contributions

Researchers and business executives have noted that organizational life is full of paradoxes (e.g., Bouchikhi, 1998; Leana and Barry, 2000; Smith and Tushman, 2005). As some have claimed that the business environment is characterized by growing complexity and turbulence (e.g., Hamel and

Välíkangas, 2003; Price Waterhouse Change Integration<sup>®</sup> Team, 1996), firms may succeed or fail based on differences in their capabilities to manage paradox (Peters, 1991). However, the theoretical and empirical works on how firms manage these tensions have remained scant (Smith and Tushman, 2005). Moreover, Andersen (2004) and Chen (2002) all argue that most research on managing paradoxical strategies exclude recognition of these phenomena by posing either/or choices rather than recognizing the possibility of both/and results. Hence, in order to advance the conceptualization and operationalization of managing these tensions, this study makes several important contributions to the growing theory on paradoxical strategies in strategic management discipline as shown in the following.

First, it is one of the very few studies that empirically examined the "both/and" perspective of the effect of paradoxical strategies on firm performance. This study had empirically tested the effect of combined paradoxical strategies on firm performance and found to be significant. This result, therefore, advances the paradoxical strategies concept that has previous been researched separately. It fulfills the paradoxical requirements for a theory of organizational change (e.g., Leana and Barry, 2000; Van de Ven and Poole, 1988). It also enriches the paradox literature by introducing the concept of "**paradoxical integration**", an idea that has been drawn from the notion from independent opposites to interdependent opposites framework proposed by Chen (2002). Theoretical standpoint argues that the concept of strategy is inherently paradoxical (de Wit and Meyer, 2005). Moreover, Lewis (2000) suggests three ways of dealing with paradox: acceptance, confrontation, and transcendence. Specifically, this study supports her thought by investigating that paradoxical integration provides one means of transcending paradox.

Second, addressing a gap in previous

researches on strategic flexibility and strategic consistency that were mainly focused on the manufacturing settings and at the operational level, this study covers managing paradoxes in service operations strategy at the corporate/strategic level. The study provided empirical evidence that the impact of strategic flexibility on firm performance depends on strategic consistency and/or environmental uncertainty as the antecedent. This study extends the previous empirical works that were conducted by Karri (2001) and Parnell (1994), and conceptual works that were proposed among others by Day and Schoemaker (2006), Ghemawat and del Sol (1998), Shimizu and Hitt (2004), and Volberda (1997).

Third, this study further extends and refines previous measure of strategic flexibility developed by Karri (2001). Unlike Karri's (2001) research which classifies the dimensions of strategic flexibility into proactive flexibility and reactive flexibility, this study uses four integrated dimensions of strategic flexibility, i.e., **pre-emptive moves**, **exploitative moves**, **protective moves**, and **corrective moves** as conceptually suggested by Evans (1991).

Fourth, drawing from the previous researches conducted by Parnell (1994, 2005b), this study proposes a firm's strategic consistency capabilities that classified into two dimensions, namely **proactive consistency** and **reactive consistency**. This adds more refined measure to the growing literature on measuring strategic consistency as a paradox to strategic flexibility (see for example Karri, 2001; Parnell, 1994; Volberda, 1999).

Fifth, the study had also empirically tested the effect of each of paradoxical strategies on financial and strategic indicators of firm performance and found only the effect of strategic flexibility on firm performance to be significant. This result also addresses a gap in the organizational effectiveness measurement literature (see for examples,

Hooley et al., 2005; Venkatraman and Ramanujam, 1986). This study holistically integrates several components of overall firm performance measurement known as accounting measures (e.g., Tangen, 2004) as well as market-based measures (e.g., De Carolis, 2003), and other measures in internal process and employee perspectives (Kaplan and Norton, 1992). To put it simply, this non-financial performance is termed as **strategic performance**.

Finally, the findings of this study are in accordance with Cameron and Quinn (1988) and Poole and Van de Ven (1989)'s theory that claims firms must build capabilities to attend to paradoxes and also consistent with Thompson (1967)'s theory that the paradox of administration involves the simultaneous searches for consistency and flexibility.

## Managerial Implications

The findings of this study generate several managerial implications. First, by understanding the strategic flexibility, strategic consistency, and environmental uncertainty, bankers should use caution in choosing paradoxical strategies that suit for their external and internal changes. Specifically, evidence from this study concluded that being flexible in strategic choices is much more beneficial towards firm performance than consistent in strategy. In banking industry context, it means that being a conservative bank in nowadays is a big challenge to become a higher performing bank. From a conservative bank to become an agile bank, it should implement strategic flexibility with strategic consistency as a "stepping stone".

Second, bank competing in turbulent environments are thus better off to develop strategic flexibility rather than relying on strategic consistency which characterizes by long-term strategic planning cycles (Hamel et al., 1999). This means that in such contexts, bank managers need to improve innovation

in services and financial innovation in grasping opportunities in the external environment (Wonglimpiyarat and Tripipatkul, 2005).

Third, to increase their flexibility, banks need to build up technology investments as well as technological capabilities. These can be acquired by pursuing merger and acquisition strategy and/or strategic outsourcing.

Fourth, it is claimed that strategic flexibility facilitates sustained growth (Hatch and Zweig, 2001). Growth strategies through organic or mechanic ways should focus more on pre-emptive and exploitative flexibilities than protective and corrective flexibilities. These can be realized through the combined deployment of flexible systems and flexible people. To achieve this, it requires the followings:

- Responsive organizational and systems capabilities to support the urgency of innovation. Top performer banks should create "seamless" front- and back office operations intensively linked and responsive to the task of satisfying target customers.
- New information-based technology that stretches beyond transaction processing to expand the knowledge base of both employees and customers alike. Top commercial banks should transform their human and capital assets into knowledge assets.
- Employees who have the ability and are given the authority to take swift action and appropriately modify their behavior and roles. Employee roles and particularly those of management should be modified to facilitate the transfer of knowledge between functions as well as to the organization from external sources.

Finally, the analysis of paradoxical strategies reveals corporate level managers need to steer their banks similar to airplanes.

Despite their "navigation systems" (e.g., risk management, compliance, controlling) banks like airplanes never seem to stay completely on course for a longer periods of time. Instead, banks implement their strategy within a certain bandwidth of consistency at different points in time. Banks competing in turbulent environments are found to "sway off course" and then "pull back on course" while the likelihoods for swaying off and pulling back seems influenced by arising opportunities.

## Policy Implications

Some recommendations for the banking regulator and the government agency alike to enhance Indonesian banking industry are as follows:

- The banking regulator should carry out detailed research into the impact of regulation and government policy on bank flexibility. With a few notable exceptions, the influence that regulation exerts on firm-level behavior and performance is largely uncharted territory. Thus, we do not have an adequate understanding of the manner in which regulated banks make strategic choices that drive performance outcomes. The results of this study can be utilized as preliminary inputs.
- The banking regulator should consider the notion of strategic flexibility into the Indonesian Banking Architecture (API), especially in strengthening focused banks category such as corporate, retail, and regional development banks.
- Slattery and Nellis (2005) argue that banks need to develop a market-oriented approach through new product development in a rapidly changing regulatory environment. Hence, the banking regulation and policy should also drive innovative banking product development. This should be equipped with a balance between the rights and

duties of product providers to develop new and innovative products and the rights and duties of customers to understand how the products they purchase meet their needs in way that offers good value for money.

- The banking regulator should encourage the commercial banks to undertake information technology investments to build up technology capabilities to boost innovative financial products and services. The use of technology would help improve economies of scale in service processes and further enable the banks to meet the challenges of foreign competition in the future.
- The passing of legislation to regulate the digital signatures enable the concept of “virtual branch office”, which gives a lot of flexibility for corporate customers, particularly small and medium enterprises. Hence, banks can offers new services, such as online cheques, statement images, account alerts, and pre-filled applications.
- For banks with limited resources in information technology, the banking regulator should issue specific regulation about outsourcing service provider which is characterized as cross-border and cross-transaction.

## **Suggestions For Further Research**

This study provides empirical evidence that paradoxical strategies are an important emerging paradigm for banking industry. General findings from this study and the

limitations cited above, pave the way for three additional extensions in future research.

First, the study should be replicated across other service industries (especially other non-bank financial services companies) with the convergence hypothesis that paradoxical strategies are more broadly generalizable in services. Note that these other industries should be surrounded by Duncan’s (1972) dimension of complex-dynamic environment.

Second, as suggested by Venkatraman and Prescott (1990), more “holistic perspective” can be carried out in a broader conceptualization of co-alignment (fit) between several characteristics of paradoxical strategies and several characteristics of environment. As a consequence, of course, the sample size should be enlarged.

Third, strategic paradox allows firms to not only choose from a set of options but also creates options that can be exercised in the future (Thompson, 1998). It is reasonable to assume that firms reserve the capability to choose from among various choices to exploit the opportunities inherent in changing environment conditions, build subsequent resources to support them, and keep an option on strategic consistency and/or strategic flexibility as times go and environments are changing. Firm with choices have accumulated capabilities that lead to competitive advantage of their rivals. Drawing from the resource-based view of the firm (e.g., Barney, 1991) and the real options framework (Bowman and Hurry, 1993), the dimensions of strategic flexibility explored in this study can be enriched by collecting data on the nature of real option value of firms’ investments.



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## Appendix A

Items used to measure model constructs: (the following items are assessed to capture perceptions of the CEO of the bank over previous years)

### Environmental Uncertainty

1. The extent to which the bank's environment (competitors, customers, depositors, technology, and regulatory) had impact on the bank over the last three year
2. The extent to which the bank's environment (competitors, customers, depositors, technology, and regulatory) became more predictable over the last three year
3. The extent to which the bank's environment (competitors, customers, depositors, technology, and regulatory) changed over the last three year

### Strategic Flexibility

The capability the bank put on ...

1. Anticipating external environmental changes
2. Making ready for change in the market
3. Becoming an agile bank
4. Flexibility
5. Developing strategies that cannot be predicted
6. Offering new services
7. Establishing new standards
8. Acting as a major change in the industry
9. Taking advantage of new and unforeseen opportunities
10. Taking advantage of opportunities arising from the environmental change
11. Developing contingencies
12. Remaining flexible in developing long-term plan
13. Creating options for growth

14. Building in slack
15. Installing buffers
16. Maintaining high cash reserves
17. Protecting itself from banking risks
18. Developing "wait and see" nature
19. Introducing extension products
20. Recovering downturns in the industry
21. Responding the competitor's mistake

### Strategic Consistency

The capability the bank put on ...

1. Maintaining consistent strategies over an extended period of time
2. Maintaining expertise/competence in the specific area
3. Instituting strategies that successful in the past
4. Initiating organizational rigidity/fixeness
5. Instituting major unchanged strategies
6. Unswerving in its strategic priorities
7. Making changes less likely
8. Recognizing when to change

### Firm Performance

The firm position compared to close competitors in the banking industry over the past three years

1. Overall profit
2. Profit margins
3. ROE
4. ROA
5. Total income
6. Total income growth
7. Market share
8. Rank in the industry
9. Customer service process
10. Commitment to learning
11. Customer satisfaction
12. Customer loyalty
13. Employee satisfaction
14. Employee loyalty
15. Providing employment

## Appendix B

The following statistical results demonstrate that the bivariate correlation between Strategic Flexibility ( $X_1$ ) and Firm Performance (Y) equal to standardized coefficient of the regression function with dependent variable Y and independent variable  $X_1$ .

The statistical tables below show that coefficient of correlation and the standardized coefficient have the same values of 0.688.

Hence, in general, the bivariate correlation can be applied to test the hypothesis on the linear effect of  $X_1$  on Y.

		<b>Y</b>	<b>X1</b>
<b>Pearson Correlation</b>	<b>Y</b>	1.000	.688
	<b>X1</b>	.688	1.000
<b>Sig. (1-tailed)</b>	<b>Y</b>	.	.000
	<b>X1</b>	.000	.
<b>N</b>	<b>Y</b>	59	59
	<b>X1</b>	59	59

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<b>(Constant)</b>	-3.441	.490		-7.024	.000
<b>X1</b>	.688	.096	.688	7.161	.000