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Exploitation Strategy and Performance of Contract Manufacturing Exporters: The Mediating Roles of Exploration Strategy and Marketing Capability

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ABSTRACT

Contract manufacturing exporters (CMEs) receive a meagre share of global value chain returns, primarily because of the mundane and exploitative nature of the activities they perform in their dependency relationships with lead firms. We posit that CMEs can enhance their performance by capitalizing on their exploitation strategy. Exploitation strategy triggers exploration strategy which requires building marketing capabilities for enhanced performance. Based on data from 154 Vietnamese CMEs, we find significant indirect only mediation effects of: 1) exploration strategy between exploitation strategy and export performance; and 2) marketing capability between exploration strategy and export performance. Further, we find significant indirect only serial mediation of exploration strategy and marketing capability between exploitation strategy and export performance. The findings are also supported and contextualized based on illustrative quotes from face to face semi-structured interviews with senior managers of 10 Vietnamese CMEs. The findings suggest that CMEs' that consciously capitalize on the exploitation strategy by seeking exploration opportunities while building their marketing capability exhibit enhanced performance.

1. Introduction

Contract manufacturing exporters (CMEs) play a significant role in the global economy. Exports by CMEs account for over half of the global trade in non-fuel goods (Gereffi and Lee, 2012; WTO, 2011). They are typically located in developing countries and produce and export goods according to a lead firm's specifications. CMEs receive orders from lead firms, run production and subsequently export goods following the lead firms' specifications (Buckley, 2009; Gereffi et al., 2005). Understanding the performance and behaviors of CMEs, which are the supply side of international outsourcing relationships, is important as they are strategic players in such relationships and their success or failure is likely to impact value chain effectiveness.

Although participating in global value chains is widely recognized as a mode of fast access to the international market for CMEs (Buckley, 2009; He and Wei, 2013), their share in value chain returns is meagre primarily because of their low bargaining power and the mundane nature of the activities they perform (Dedrick et al., 2010; Lavie, 2007; Shin et al., 2012). CMEs' low bargaining power results from their dependence on lead firm's resources while their own resources are much less needed by the lead firm (Casciaro and Piskorski, 2005). CMEs are not scarce and lead firms have the options to switch to other suppliers which again increases the CME's

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dependency on the lead firms (Lippman and Rumelt, 2003). Moreover, their activities are mundane and exploitative in the sense that they manufacture as per the lead firm's specifications and have little opportunity to explore beyond the given specifications (Buckley, 2009; Gereffi et al., 2005). So, the question arises as to how CMEs can enhance their performance. The answer lies in capitalizing on their exploitation strategy. In summary, we posit that exploitation strategy triggers exploration strategy which requires building marketing capabilities for enhanced performance.

Exploitation strategy relates to competition-based activities to exploit current capabilities and knowledge while exploration strategy implies entrepreneurship behavior driven by risk-taking activities to explore new competencies and opportunities (Hitt et al., 2011). Examples of exploitation strategy for CMEs include leveraging existing capabilities such as manufacturing their existing products with more efficiency through process upgrading which includes improvement in machinery and production capability. Exploration strategy, on the other hand, includes both product and functional upgrading. Product upgrading is making new or higher value added products while functional upgrading is moving up the value chain. Adding value to existing products for current buyers or modifying current products to sell them to new markets are the examples of exploration strategy.

We borrow insights from the resource dependency theory and the ambidexterity organization hypothesis to explain how CMEs can capitalize on their exploitation strategy to enhance their performance. The ambidexterity hypothesis argue that though path dependencies favor choosing only one strategy based on their experience and learning, firms strive to balance both the exploratory and exploitative activities in the long run (Lavie and Rosenkopf, 2006; O'Reilly and Tushman, 2004). On the other hand, the resource dependency theory suggests that firms aim to reduce the uncertainty and power imbalance which arises because of dependency relationships (Pfeffer and Salancik, 2003). CMEs are weaker firms in their power asymmetric relationships with the lead firms. They need to manage this dependency to enhance their performance. Since firms need to balance exploitation and exploration activities for sustained performance (Raisch et al., 2009) and CMEs typically engage more in exploitation activities, their next course of action becomes exploratory activities. Thus, CMEs' existing exploitation strategy is likely to trigger their exploratory entrepreneurial behavior.

CMEs move to exploration activities to use a dual strategy whereby they simultaneously interact with the resource-rich partner (Gras and Mendoza-Abarca, 2014; Su et al., 2014) while pursuing entrepreneurship or searching for new market opportunities outside of the current dyad (Casciaro and Piskorski, 2005). Thus, they just don't rely on exploitation strategy, being insufficient for the wealth creation, as it can co-exist with exploration strategy (Sirén et al., 2012). Research shows that simultaneously adopting exploitative and exploratory behaviors benefits firm performance (Shirokova et al., 2013; Sirén et al., 2012). Part of the positive effect of this duality on performance has been suggested to stem from its ability to transform a firm's resource base (Kuratko et al., 2015). The resource base considered in this study is the marketing capability of CMEs. Although transforming the resource base is one of the key purposes of the dual pursuit of exploitation and exploration strategies (Hitt et al., 2011; Kuratko et al., 2015) the examination of how these two strategies enhance a firm's long-term viability through resource transformation is still limited (Vandaia and Zaheer, 2014; Yu and Sharma, 2016).

We contribute by enhancing the understanding of how CMEs can capitalize on their exploitation strategy to enhance performance: by undertaking exploration activities and transforming resources i.e. marketing capability. Sirén et al. (2012) note that exploitation and exploration strategies do not fully explain performance because of the existence of mediators. They examined the mediating effects of strategic learning. We add to the literature by examining another mediator, marketing capability, which is relevant for the CMEs under investigation. Marketing capability is a strategic resource that has been found to have significant influence on firm performance (Krasnikov and Jayachandran, 2008). Moreover, the current literature examines the balancing and moderation effects of exploitation and exploration strategy (Dunlap-Hinkler et al., 2010; Raisch and Birkinshaw, 2008; Raisch et al., 2009; Sirén et al., 2012). We suggest the 'mechanism' or mediation effects of exploration strategy. We argue that CMEs' move to exploratory activities is triggered by their exploitation activities. In other words, exploitation strategy by itself is not sufficient, rather it is the exploration strategy and enhanced marketing capability that explains their superior performance. Thus, we suggest that an alignment between competitive behavior (exploitation strategy) and entrepreneurial behavior (exploration strategy) can transform firms' strategic resources to superior performance. We contribute by examining the combined impact of the three behaviors: competitive behavior (exploitation strategy), entrepreneurial behavior (exploration strategy) and resource transformation.

The remainder of the paper is organized as follows. The next section builds the theoretical model which is followed by a section on Hypotheses development. Then the Methodology used and Analysis and results are presented. The last section presents Discussion and conclusions including Theoretical implications and Managerial implications and Limitations of the study.

2. Theoretical model

We theoretically propose (Fig. 1) that CMEs can enhance their performance by capitalizing on their exploitation strategy and shifting their strategic direction through unilateral strategies and building related capabilities. We further argue that the other option of restructuring activities through bilateral tactics is not preferred by CMEs. While adopting unilateral tactics, CMEs are leveraging their current exploitation activities with the lead firms. This results in their enhanced performance.

The proposed theoretical model primarily draws from the resource dependence theory and ambidextrous organization hypothesis. The resource dependency theory assumes that firms do not possess sufficient resources and capabilities and thus seek complementary resources from the external environment to achieve their strategic goals (Hillman et al., 2009; Pfeffer and Salancik, 2003). This leads to dependence on other organizations as well as uncertainty of resource access and utility. The extent of dependence depends on the importance of resources to the firm, its ability to control those resources, and the autonomy of resources allocation and usage (Pfeffer and Salancik, 2003). The more a firm's valued resources are controlled by the external environment, the more it depends on other

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