

Slack and the performance of state-owned enterprises

Ciprian V. Stan · Mike W. Peng · Garry D. Bruton

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Abstract Organizational slack has been recognized as critical to firm performance, although its impact is not always positive. Slack may be used to fuel innovation or alternatively excess resources may be squandered on pet projects. However, most research on slack is rooted in studying private firms in developed economies, especially the United States. Whether prior research on organizational slack can readily inform our understanding of state-owned enterprises' (SOEs) behavior is questionable since SOEs prioritize goals such as social welfare and full employment differently than do the privately owned enterprises (POEs). The differences between SOEs and POEs influence their sources and use of slack due to the nature of their ownership, budget constraints, and agency relations. To bring insight to this issue we develop an institutional change lifecycle model to study the relationship between slack and the economic and social aspects of SOE performance.

Keywords State-owned enterprises · Slack · Performance

C. V. Stan (✉) · M. W. Peng
Jindal School of Management, University of Texas at Dallas, 800 West Campbell, SM 43,
Richardson, TX 75080, USA
e-mail: ciprian.stan@utdallas.edu

M. W. Peng
e-mail: mikepeng@utdallas.edu
URL: www.mikepeng.com

G. D. Bruton
Neeley School of Business, Texas Christian University, Fort Worth, TX, USA
e-mail: g.bruton@tcu.edu

What roles does organizational slack play in state-owned enterprises (SOEs)?¹ Do SOEs obtain and utilize slack in a manner similar to privately owned enterprise (POE)?² Does the use of slack by SOEs vary based on their institutional environment? Our SOE focus is motivated by the high incidence of SOEs in the world's rapidly developing economies (Peng, Bruton, & Stan, 2013). SOEs represent 80 % of China's stock market capitalization, 62 % of Russia's, and 38 % of Brazil's (Whittington, 2012). Even in the developed economies of Western Europe the state is a controlling shareholder in 15 % of listed firms in Austria and Finland and 10 % in Italy (Faccio & Lang, 2002). SOEs represent approximately 5 % of GDP in OECD countries and 10 % of the global GDP (Budiman, Lin, & Singham, 2009). Some examples of SOEs include the world's largest natural-gas company, Russia's Gazprom, all of the 13th largest oil companies in the world based on oil reserves, and the world's largest mobile-phone operator, China Mobile, with its 600 million subscribers (*Economist*, 2012).

Slack is defined as actual or potential resources that enable firms to adapt to internal and external pressures, and allows the pursuit of goals that are outside the organization's main strategy (Bourgeois, 1981; Tan & Peng, 2003). Organizations may use slack as a buffer in market downturns, as a response to performance disruptions, or as a source for experimentation with cutting-edge projects (Cheng & Kesner, 1997; Cyert & March, 1963; Meyer, 1982). Previous research, focusing mostly on POEs in the West, offers conflicting findings on the relationships between organizational slack and firm performance (Bradley, Shepherd, & Wiklund, 2011; Daniel, Lohrke, Fornaciari, & Turner, 2004; George, 2005; Greenley & Oktemgil, 1998). Western POEs operate in market economies facing a relatively stable institutional environment that results in convergence around practices and structures based on the existing norms in the field (DiMaggio & Powell, 1983). However, while some SOEs exist in most developed economies, they are predominantly located in emerging economies where many firms face institutional upheaval and transformation that influence their pattern of strategic actions and implicitly their allocation of slack resources (Hoskisson, Eden, Lau, & Wright, 2000; Peng, 2003; Wright, Hoskisson, Filatotchev, & Peng, 2005).

The relationship between slack and firm performance with a specific focus on SOEs has received limited attention in extant literature, with few exceptions that focus on China (Ju & Zhao, 2009; Liu, Ding, Guo, & Luo, 2013; Peng, Li, Xie, & Su, 2010; Su, Xie, & Li, 2009; Tan & Peng, 2003). Our SOE focus is motivated by their different organizational goals when compared to POEs; goals that vary between social focus and profitability, depending on the institutional norms and governmental shareholder preference (Peng et al., 2013). SOE organizational goals, which are set by the governments that own them, strongly influence their use of slack resources (Aharoni, 2000). Facing soft budget constraints (i.e., implicit governmental

¹ We use the term SOE to define firms created by governments to pursue commercial as well as social actions on their behalf, in which the state owns a minimum 10 % of the shares (according to the United Nations Conference on Trade and Development). SOEs are also known as government-sponsored enterprises in the United States, crown corporations in Canada, government business enterprises in Australia, public sector undertakings in India, and government-linked companies in Malaysia, among others.

² In contrast to SOEs, we define POEs as firms that have private ownership, both private and publicly listed.

guarantees), SOEs gain a source of slack unavailable to their POE competitors (Cull & Xu, 2000; Kornai, Maskin, & Roland, 2003; Majumdar, 1998; Peng & Heath, 1996). We aim to extend our theoretical understanding of this important, enduring organizational form by showing how various SOEs, functioning in countries at different levels of institutional development, obtain and utilize slack.

Given the high level of privatization within emerging economies as well as the persistence and continuous relevance of SOEs over the recent decades (especially since 2008), this article attempts to take a picture of a fast-moving target (Filatotchev, Buck, & Zhukov, 2000; Ramamurti, 2000; Rodriguez, Espejo, & Cabrera, 2007; Wang & Judge, 2012). The analysis will present an agency perspective, as well as an institution-based view, of the relationship between slack and performance in the case of SOEs (Peng, Sun, Pinkham, & Chen, 2009).

Our article is organized as follows. First, we present a review of extant literature on slack and propose a way to group the different overlapping categories into four main groups. Second, we discuss SOEs and show how they can be subject to soft budget constraints (i.e., implicit state backing) that may confer them advantages not available to POEs. Third, we develop the institutional change lifecycle model to account for the varying stages of SOEs transitions from planned to market economies as well as for the social and economic goals of their owners, the state. Fourth, we develop a set of five propositions addressing the effects of slack in the context of SOEs. We conclude by presenting our contributions to previous literature, showing how different categories of slack are related to SOE social and economic performance.

Background

Slack

Organizational slack represents a cushion of excess resources that organizations may use in a discretionary manner (Bourgeois, 1981). Alternatively, slack is the pool of resources held by organizations that exceed the minimum needed to maintain a certain output level, such as redundant employees and unused capacity, in addition to the opportunities that firms choose not to pursue (Nohria & Gulati, 1996). Slack has the following roles in organizations: it (1) provides a cushion of spare resources that can act as shock absorbers for the workflow, preventing disruptions; (2) allows firms to adjust to major shifts in the environment by buffering their technical core; (3) facilitates creative behavior, allowing experimentation and new product innovation; (4) acts as an inducement for firm members to remain in the organization, due to high salaries; and (5) provides resources for conflict resolution, allowing pet projects (Bourgeois, 1981; Cyert & March, 1963; Sharfman, Wolf, Chase, & Tansik, 1988; Tan & Peng, 2003; Thompson, 1967).

Organizational theories consider slack as resources that buffer the firms' technical core and allow for experimentation in response to environmental changes, and generally view slack to be positively related to firm performance (Cyert & March, 1963; Pfeffer & Salancik, 1978). However, the relationship is predicted to be negative when looking through an agency theory lens, due to the potential inefficiencies caused by holding idle resources, satisficing, and self-serving managerial behavior

(Fama, 1980; Jensen, 1986; Jensen & Meckling, 1976). Thus, one line of research that follows agency theory suggests that the excess resources represented by slack should be eliminated by the firm (Phan & Hill, 1995; Sachs, 1993). Yet other researchers have shown that the relationship is curvilinear, having an inverse U-shape. In other words, with too little as well as too much slack being problematic, firms need to seek to maintain an optimum level of slack (Bourgeois, 1981; George, 2005; Tan & Peng, 2003).

There have been many different ways to categorize slack in the literature (see Table 1). Due to the high degree of overlap based on relatively similar theoretical rationalization and similar empirical operationalization, we group the various categories of slack into four main groups. First, unabsorbed slack represents uncommitted liquid resources (Singh, 1986), and is similar to available slack, which measures untapped resources to which the firm has immediate access (Bourgeois & Singh, 1983). Unabsorbed slack has also been categorized by some researchers as financial slack (Bradley et al., 2011; Mishina, Pollock, & Porac, 2004). There is a high degree of overlap between the concepts of unabsorbed slack and high discretion slack—available, visible, and easy to deploy assets (Simsek, Veiga, & Lubatkin, 2007; Sharfman et al., 1988; Sharma, 2000). Second, absorbed slack represents expenses greater than actually needed by the organization (Singh, 1986) and is similar to recoverable slack—resources already absorbed in the organization as excess costs, but that may be recovered through organizational redesign (Cheng & Kesner, 1997). Low discretion resources are similar to absorbed slack, as they are difficult to access and may offer the firm a low level of flexibility (Sharfman et al., 1988). Third, potential slack represents future resources that may be obtained from the environment (such as loans obtained through debt financing) or the raising of equity capital (Bourgeois, 1981; Cheng & Kesner, 1997). Fourth, human resource (HR) slack represents the number of available employees relative to an industry target level (Mellahi & Wilkinson, 2010; Mishina et al., 2004). To clarify, Fig. 1 illustrates the overlapping categories of slack.

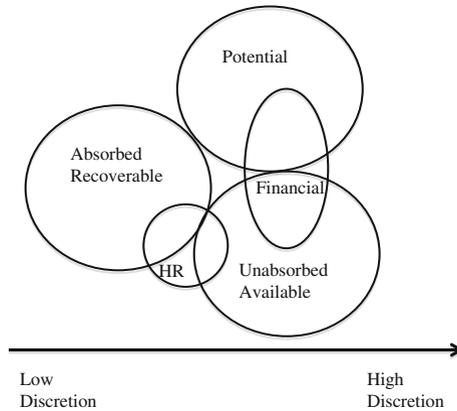
Table 2 presents a review of recent slack research over the past decade (2003–2013). Unabsorbed slack can be easily redeployed by the organization for alternative purposes, representing a fast solution in response to environmental changes that may confront the organization (Tan & Peng, 2003). Unabsorbed slack is well explained by organizational theory, which posits that slack has a positive effect on firm performance due to its high degree of discretion, and is considered critical for innovation-based strategies (O'Brien, 2003; Peng et al., 2010). Providing the highest degree of discretion, unabsorbed slack is positively related to firm acquisitions (George, 2005; Iyer & Miller, 2008). Furthermore, unabsorbed slack strengthens the relationship between acquisitions and firm performance during environmental jolts, while weakening it before and after the environmental jolts (Wan & Yiu, 2009). When organizations are confronted with a high degree of environmental dynamism, such as those faced by firms operating in emerging economies, unabsorbed slack is critical in sustaining a competitive advantage (Su et al., 2009).

Absorbed slack cannot be easily redeployed by the organization, in part due to its high level of asset specialization (Love & Nohria, 2005). As a result, absorbed slack is associated with a reduced focus on exploration and an increased focus on exploitation activities (Voss, Sirdeshmukh, & Voss, 2008). Additionally, Iyer and Miller (2008) find that absorbed slack is irrelevant when undertaking acquisitions. However, Love and

Table 1 Slack types

Type	2. Absorbed			3. Potential	4. Human resource				
	Unabsorbed	Available	High discretion			Financial	Absorbed	Recoverable	Low discretion
Definition	Uncommitted liquid resources	Untapped resources, immediate access	Easy to deploy resources	Working capital to meet current needs	Excess costs, committed resources	Resources already absorbed as excess costs	Hard to deploy resources	Resources that could be obtained from environment	Available employees relative to industry target level
Measure	(Cash + Marketable securities)/CL (Singh, 1986)	Current assets/liabilities (current ratio) (Bourgeois & Singh, 1983)	Cash reserves (for the year) (George, 2005)	CA-CL (Mishina, Pollock, & Porac, 2004)	AR/Sales	AR/Sales	Debt/Equity (George, 2005)	Interest coverage ratio (Presence of PS)	(# employees/firm size)—(Avg. ind. size/avg. ind. sales) (Mellahi & Wilkinson, 2010);
	(CA-CL)/TA (Peng et al., 2010)	Cash/Book value CA (Latham & Braun, 2009)			Inventory/Sales	Inventory/Sales		Debt/Equity (Lack of PS) (Bourgeois & Singh, 1983)	(Firm employees/Firm sales)—(Industry employees/Industry sales) (Mishina et al., 2004)
					SG&A/Sales	SG&A/Sales (Miller & Leblein, 1996)			
					Working capital/Sales (Singh, 1986)	SG&A/Sales (Bourgeois & Singh, 1983)			

CA Current assets, CL Current liabilities, TA Total assets, AR Accounts receivables, SG&A Sales, general and administrative expenses, PS Potential slack

Fig. 1 A typology of slack types

Nohria (2005), who conceptualized firm downsizing as a way to reduce slack, reported that firm performance will improve following downsizing if a high level of absorbed slack is present. On the other hand, agency theory claims that absorbed slack has a negative effect on firm performance, because such resources may promote pet projects, which are unrelated to the firms' main objectives, and rarely result in economic benefit (Ju & Zhao, 2009). Organizations cannot immediately redeploy this type of slack. They have to restructure operations, thus having a lower level of discretion, presenting an inverse U-shaped relationship to performance (George, 2005).

Potential slack provides a higher level of flexibility for organizations in comparison to available slack, as it can be obtained in a relatively short time frame from financial organizations through debt financing or through equity capital (Iyer & Miller, 2008). Potential slack is positively related to firm performance and to managerial risk-taking (Daniel et al., 2004; Martinez & Artz, 2006). HR slack represents excess staff beyond what is required for efficient operation (Williamson, 1963: 242). Excessive unproductive staff may be detrimental to firm performance, however, due to the possibility of using this resource for buffering environmental shifts and in the creative process. On the other hand, HR slack has a positive relation to firm performance (Gary, 2005). Mellahi and Wilkinson (2010) found that following aggressive downsizing firms adapt over time to drastic reductions in HR slack by developing new structures and routines that are suitable to the new level of slack.

A meta-analysis performed by Daniel et al. (2004) supports the view that overall, slack is a beneficial resource rather than a form of inefficiency. Potential and available (unabsorbed) slack present a stronger relationship with firm performance when compared to recoverable (absorbed) slack, indicating that easily accessible resources are crucial to economic performance (Daniel et al., 2004). One caveat is that most of the studies surveyed by Daniel et al. (2004) are done in Western market economies, with a focus on POEs. As a result, whether these relationships can hold in SOEs remains to be seen.

State-owned enterprises (SOEs)

As the main regulator of the economy, the state is not only the source of formal institutions (North, 1990), but is also a significant factor in many economies (Hou &

Table 2 A summary of key previous slack studies (2003–2013)

Authors/Sample	Slack measures	Results
Tan & Peng (2003): a survey sample (57) & an archival sample (1532) of SOEs in China	Absorbed & unabsorbed	Inverse U-shape impact of slack on performance. Unabsorbed slack better explained by OT; absorbed slack by AT.
Tan (2003): 17,000 large & medium Chinese (SOEs)	Absorbed & unabsorbed	Slack has positive influence on firm performance. Inverse parabolic shape.
O'Brien (2003): 16,358 public companies in the US (POEs)	Financial	Financial slack critical for innovation-based strategies.
Daniel et al. (2004): meta-analysis of 80 samples from 66 studies (POEs & SOEs)	Available, recoverable, potential	Positive relationship between the 3 slack types and performance. Controlling for industry strengthens potential slack performance relation. Lagged slack does not improve it.
George (2005): 900 private firms (POEs)	High discretion, low discretion, transient	Inverse U-shape for low-discretion slack to performance; positive linear for high-discretion slack. Transient slack has positive, concave relation to performance.
Love & Nohria (2005): 100 largest US industrial firms (POEs)	Absorbed	Downsizing is likely to lead to better performance if firms have high slack, broad scope.
Simsek et al. (2007): 495 small medium firms (POEs)	Discretionary	Discretionary slack mediates the relationship between managerial perceptions of (1) environmental munificence and dynamism and (2) corporate entrepreneurship.
Chen & Miller (2007): US firms (POEs)	Available	Slack is positively related to R&D search intensity.
Kim et al. (2008): 253 Korean firms (POEs)	Financial	Financial slack has an inverted U-shaped relationship with R&D investments. Family ownership positively moderates the relationship.
Voss et al. (2008): 163 US nonprofit firms (POEs)	Financial, customer relational, operational, HR	Relational and operational slack is negatively related to exploration. HR and operational slack are positively related to exploitation.
Danneels (2008): 77 US firms (POEs)	Scale based on financial and HR	Slack has a U-shaped lagged effect on marketing and second-order competences.
Iyer & Miller (2008): 6,302 US firms (POEs) engaged in M&As	Absorbed, unabsorbed, potential	Potential and unabsorbed slack has a positive relation to acquisitions.
Su et al. (2009): 967 firms in China (POEs & SOEs)	Unabsorbed	Unabsorbed slack is critical to sustain competitive advantage, especially when firms confront environmental dynamism and scarcity.
Ju & Zhao (2009): 12,189 firms in China (66 % SOEs, 18 % POEs, 16 % Foreign)	Absorbed, unabsorbed	The relation between slack and performance is stronger for POEs than for SOEs or foreign enterprises.
Wan & Yiu (2009): 78 firms in Hong Kong (48) & Singapore (30) (POEs)	Unabsorbed	Slack improves performance and strengthens the positive relation between acquisitions and performance during an environmental jolt. Slack worsens performance and

Table 2 (continued)

Authors/Sample	Slack measures	Results
		weakens the above relationship before and after the jolt.
Latham & Braun (2009): 327 unprofitable US firms (POEs)	Available	Firms with slack and high managerial ownership jointly reduce innovation when facing decline.
Peng et al. (2010): 300 firms in China: SOEs (163) & POEs (137)	Unabsorbed	Positive relationship between slack and performance. CEO duality weakens the relationship in SOEs and strengthens it in POEs.
Mellahi & Wilkinson (2010): 258 medium & large downsizing UK firms (POEs)	HR	Sudden decline in slack following downsizing has a temporary negative effect on innovation. In time firms adapt to the new level of slack.
Bradley et al. (2011): 951 new Swedish firms (POEs)	Available (financial), recoverable, potential	For new firms financial slack is: (1) related to performance in low discretion environments; (2) provides buffering if hostile & dynamic (3) flexibility if munificent & dynamic.
Liu et al. (2013): 308 Chinese firms (POEs & SOEs)	Absorbed, unabsorbed	In high-tech settings unabsorbed slack is more strongly positively related to innovation than absorbed slack is.

HR Human resource

Moore, 2011; Okhmatovskiy, 2010). In many countries, the state has an ownership stake in numerous firms (Aharoni, 2000; La Porta, Lopez-de-Silanes, & Shleifer, 1999). The state can be perceived in some cases as an aggressive entrepreneur wanting to develop its SOEs, while in other cases as a custodian of troubled enterprises, stepping in when the private sector fails (Wengenroth, 2000). Governments retain some control over SOEs even following their privatization, due to the state's residual ownership and firms' dependence on the state for resources (e.g., procurement orders) (Gupta, 2005; Uhlenbruck & De Castro, 2000). Governments also control such firms by setting industry regulations as well as the rules to be followed after privatization, especially in regard to layoffs (De Castro & Uhlenbruck, 2003; Li & Lu, 2012; Peng, Filatotchev, & Buck, 2003; Peng & Heath, 1996).

While there has been a general tendency within the past decades to reduce the overall level of state ownership through privatization efforts, SOEs have not been eliminated, and many are growing stronger (Bortolotti & Faccio, 2009). Recent studies looking at the ownership patterns of firms within emerging economies, especially in China and Russia, have concluded that state ownership of firms will not disappear in the near future (Lin & Milhaupt, 2011; Okhmatovskiy, 2010; Puffer & McCarthy, 2007). In effect, SOEs are actually on the rise in some countries, such as Russia and Venezuela, where the privatization movement has been reversed and where certain SOEs acquire some of their private competitors (*BusinessWeek*, 2011; *Economist*, 2010; Puffer & McCarthy, 2007).

SOEs are organizations founded by governments having goals along two distinctive dimensions of performance: social and economic (Aharoni, 1981). SOEs are located predominantly in emerging economies, but are also present in developed economies in industries such as energy, transport, and utilities (Goldeng, Grunfeld, & Benito, 2008). Even in the United States, one of the most pro-market developed economies, in extreme circumstances the state intervened in the economy, in effect temporarily nationalizing firms, such as GM and AIG (*Economist*, 2013). Many SOEs own certain resources that governments may wish to keep under control, such as transportation and communication networks, in addition to natural resources (Okhmatovskiy, 2010).

In theory, SOEs are owned by all citizens in a country. However, in practice they are controlled by state bureaucrats and politicians. The firms' citizen-owners have no corporate governance mechanisms to monitor the running of SOEs, which may be run according to politicians' goals (Cuervo-Cazurra & Dau, 2009). Thus, in addition to social and economic performance goals, SOE managers must also balance bureaucratic and political interference from such officials (Lawson, 1994). Officials' goals typically support their own political interest, but do not necessarily support social or economic performance—especially since profits go into the governments' coffers, not to the bureaucrats themselves (Shleifer & Vishny, 1994). Such examples, illustrated by SOEs in Russia in the 1990s and Cuba today, exhibit control without cash flow rights and have socially harmful political objectives (Boycko, Shleifer, & Vishny, 1997). Overall, political interference results in lower managerial discretion over firm strategy, especially if the SOEs have a high level of dependence on the state for resources (Lioukas, Bourantas, & Papadakis, 1993). Further, SOE managers can lead their firms in a way conducive to obtaining personal political or economic benefits, such as senior governmental positions (Hung, Wong, & Zhang, 2012).

While POEs' owners usually have economic performance as their main organizational goal, the owner of SOEs, the state, may have additional multiple social goals, such as maximizing social welfare and providing employment protection, resulting in different slack generation and usage patterns (Aharoni, 1981). The pursuit of social goals and full employment may override the pursuit of profits and development of new products, thus potentially harming firm growth. However, even though SOEs theoretically have stated social goals, depending on the institutional environment, they may not act more in the public interest than POEs do, in part due to the incentive structure faced by state bureaucrats (Boycko et al., 1997).

Economic performance and efficiency are not necessarily the overriding concerns of SOE managers, given that they are less sensitive to market pressures. For example, Chinese SOEs' rate of annual growth over the period of 1980–1995 was 7.8 %, which would be enviable elsewhere. However, this observation pales when considering that the overall industrial Chinese output was double that rate over the same period. This shows that SOEs, even when growing aggressively, still lagged behind POEs by far in growth rate and efficiency (Lin, Cai, & Li, 2001). Lower SOE economic performance was also observed in a Norwegian sample, where high competition did not contribute to learning from POEs and to efficiency improvements (Goldeng et al., 2008).

Soft budget constraints (SBCs)

Soft budget constraints (SBCs) is a behavior typical of many SOEs that generate consistent losses, where such firms develop an expectation of being bailed out by

governments with subsidies or other financial incentives (Kornai et al., 2003; Lin & Tan, 1999). Many of the problems faced by SOEs, such as low efficiency and profitability, are traced to SBCs, as firms can count on the state to rescue them in case of failure (Kornai, 1992). The behavior of SOEs is influenced by this implicit governmental safety net that insures their survival.

The existence of SBCs results in a low focus on utilizing resources efficiently, therefore a low emphasis on profitability and economic performance. For POEs firm success or profitability breeds slack, and failure typically results in potential organizational demise through bankruptcy (Cyert & March, 1963). Conversely, many SOEs can operate at a loss due to their SBCs, thus generating low or no slack, instead depending on their state shareholder for external support (Majumdar, 1998). Such SOEs benefit from barriers to entry by having their markets protected from potential entrants, thus having little incentive to increase efficiency due to low or non-existent competition. More importantly, these SOEs benefit from barriers to exit, due to the state's safety net, which may not allow them to fail (Majumdar, 1998). As a result, such insulation from competition leads to low efficiency, resulting in low generation of profits and slack. As slack resources are not generated from within the SOEs, the state provides additional resources, such as subsidies and preferential rate loans—that in the case of China can be 3 % lower for SOEs than that for POEs, if POEs can even obtain state-owned bank financing (*Economist*, 2012). Thus, the growth of some SOEs is not financed using their own absorbed and unabsorbed slack resources, but relies on subsidies and potential slack guaranteed by the firm's controlling shareholder, the state (Song, Storesletten, & Zilibotti, 2011).

Due to the widespread presence of this organizational form worldwide, in various institutional environments, it is difficult to consider the influence of slack on SOEs as a unified group. Firms exhibit different characteristics derived from their historical development and shaped by the institutional environment they face in their home countries. We will use the institution-based view to analyze SOE behavior (Peng et al., 2009), as SOEs make different choices regarding the allocation of slack resources based on their stage of institutional development (Peng, 2003). To clarify our discussion we develop the institutional change lifecycle model.

Institutional change lifecycle

This section develops an institutional change lifecycle model. The concept of institutional change lifecycle is important because a major challenge in describing SOE behavior is addressing both its organizational goals mandated by its state owner and its country-specific institutional characteristics. SOE behavior is usually influenced both by the changes in the institutional environment and by the performance objectives of governmental owners. However, prior SOE literature either focuses on how institutional changes (e.g., institutional transitions from planned to market economy) influence SOEs, behavior (Child & Tse, 2001; Krug & Hendriscske, 2012; Meyer & Peng, 2005; Peng & Heath, 1996; Tan & Tan, 2005; Zhou, Tse, & Li, 2006), or exclusively discusses the business objectives of SOEs (Aharoni, 2000; Kornai, 1992). Specifically, the literature has distinguished among the different organizational goals of SOEs, by looking at the level of political involvement in SOEs decision making

and social versus economic performance orientation (Aivazian, Ge, & Qiu, 2005; Cui & Jiang, 2012; Hung et al., 2012).

Another stream of research has looked at the SOEs' changing organizational goals following partial privatization, and its effect on firm performance, as higher levels of profit orientation are instituted by the non-state investors (Borisova & Megginson, 2011; Goldeng et al., 2008). Here, research suggests that SOEs in planned economies and in market economies typically have low levels of economic performance (Aharoni, 1981; Cui & Jiang, 2012; Goldeng et al., 2008; Kornai, 1992; Lioukas et al., 1993). How businesses function and how the objectives of SOEs change along with institutional change is underdeveloped in the literature despite the abundant literature on SOEs (Peng, 2003; Peng et al., 2013).

To address this deficiency, we propose a two-dimensional framework to advance our understanding of how SOEs' behavior is determined concurrently by the level of domestic institutional change and government goals for firms. We identify implications of the SOEs' position in the institutional change lifecycle model for their sources and uses of slack resources. To clarify our discussion we develop Fig. 2.

Based on their level of profit orientation and social versus economic performance goals, SOEs behave differently. The domestic market's economic orientation (planned versus market) determines the behavior of SOEs. Additionally, in both planned and market economies, the goals of SOEs vary based on the states' goals for the firm. If social goals and societal welfare are emphasized over economic performance, the firm will have a low level of profit orientation. Such firms are likely to receive additional resources from the state, and receive lower targets for economic performance. Alternatively if economic performance is emphasized, under a high profit orientation SOEs, behavior varies based on the institutional environment. We can improve our understanding of SOE behavior by simultaneously considering both dimensions based on their position on the institutional lifecycle model.

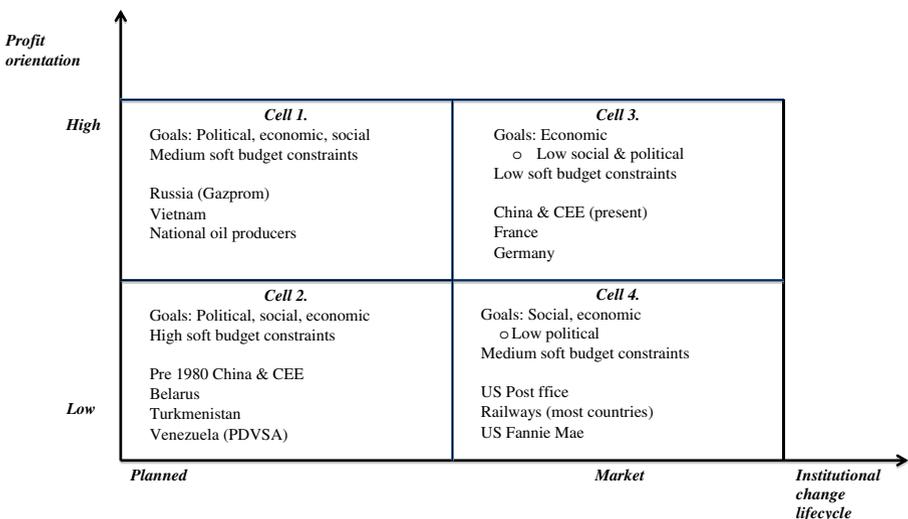


Fig. 2 SOE categories

SOEs in cell 2

SOEs in cell 2 are our reference point, as they represent firms in emerging economies at the beginning of their transitions from central planning to market competition. These firms have political and social goals with a lower focus on economic performance (Aharoni, 1981). Chinese and Central and Eastern Europe (CEE) SOEs prior to the 1980s, before institutional reforms shifted their orientation towards a market economy, were in this situation, having organizational goals that balanced social protection with a lower focus on profitability. Current day North Korean and Cuban SOEs are also in this category. SOEs in cell 2 are competing for scarce resources and seeking to limit their dependence on uncertain suppliers. In order to develop a cushion of spare resources needed to prevent disruptions in the workflow and to buffer their core, SOE managers rely on network ties and production internalization (Kornai, 1992; Peng, 2003). To avoid the all too-frequent shortages, and in order to obtain additional funds to meet state plans, managers bargain with state officials and overstock scarce resources—or unabsorbed slack—when possible (Kornai, 1992; Tan, 2003). The level of decisions that SOE managers have is limited, as firms are in fact only units of production, a part of the greater central planning system (Estrin, 2002; Tihanyi & Hegarty, 2007). Even if firms do not achieve economic performance that will allow them to generate slack internally, they benefit from the state's safety net due to SBCs. High performance standards are not required of firms to generate potential slack, however, when the firms do produce profits, thus generating unabsorbed slack internally, they face the potential of expropriation by the state (Tihanyi & Hegarty, 2007).

SOEs in cell 2 maintain a high level of HR slack as mandated by the state for social protection (Aharoni, 1981; Peng & Heath, 1996). However, the excessive HR slack is typically not used by firms to spur innovation, as research and development (R&D) is typically pursued in independent research institutes (Lin, Cai, & Li, 1998; Lioukas et al., 1993; White, 2000). By holding unabsorbed slack, SOEs are able to maintain a buffer that enables them to function when their competitors are faced with shortages due to the infrequent flow of resources. SOE managers may stockpile and hide slack resources from state bureaucrats in order to protect their firms from environmental turbulence (Kornai, 1992). As firms move along the institutional lifecycle, transitioning from cell 2 to others, such slack hiding negatively impacts profitability, and is increasingly not permitted by the markets.

SOEs in cell 4

As the institutional environment of emerging economies transitions from planned towards market orientation (cell 4), managers gain more responsibility and discretion. Thus, they are better able to influence firm performance. At this stage, SOE goals are predominantly social and economic performance while political goals are secondary. Firms have a medium level of SBCs, still having the state's implicit guarantee (Kornai et al., 2003). Increased market competition and “selective pruning” by the state, which aim to maintain only the better performing SOEs, force firms to generate higher levels of slack internally (*Economist*, 2012). In addition to unabsorbed and absorbed slack generated internally, SOEs in cell 4 continue to have potential slack

due to the guarantee presented by their state shareholder and their SBCs. Although SOEs do maintain increased HR slack for social protection, the levels are lower than in cell 2, due to increased firm efficiency.

While firms operating in cell 4 environments face the institutions of a market economy, their strategic actions are severely restrained by their state owners. This implies that SOEs in this group are likely to have potential slack from the implicit safety net that the state provides them in order to fulfill certain social goals. In developed economies, an example is the US Postal Service, which is not allowed by regulators to severely raise prices, despite its functioning in a market economy. This SOE's social goal is to deliver mail to all American citizens for an affordable low price.

SOEs in cell 1

SOEs in cell 1 have profitability as an important organizational goal, but work in largely unreformed emerging economies, where state bureaucrats still play an important role in business decisions. SOEs have performance and social goals but are heavily influenced by political interference (Puffer & McCarthy, 2007). The weak legitimacy of institutions in these emerging economies forces firms to rely on networks ties (Peng, 2003). SOEs are run for the benefit of politicians, who may force their own political and social goals on firms (Puffer & McCarthy, 2011). For example, the Russian government has high influence over the actions of many of the country's largest SOEs, such as Russian Railways. The firm's CEO requires approval from the Kremlin for most decisions, including those related to the use of the firm's available slack (*Economist*, 2012). Such political control interferes with the best use of firm slack, by redirecting it for purposes best suiting the needs of elected officials.

SOEs in cell 3

SOEs in economies that move along the institutional change lifecycle from central planning to market competition and that are mandated by the state to pursue a profit orientation by decreasing demands for social protection correspond to cell 3. In this stage managers have a high level of discretion over firm strategy, focusing on improving profit-based and efficiency-based performance measures, and responding strategically to environmental and competitive forces (Liu et al., 2013; White & Liu, 1998). Firms in cell 3 generally face *hard* budget constraints, as they do not receive support from the state to cover potential deficits, and thus lose the resulting slack (Firth, Lin, & Wong, 2008; Kornai et al., 2003). However, SOEs operating in this market tend to be more efficient, striving to successfully function in a market economy. Many SOEs in this category gain additional potential slack by being deemed national champions: their governments want them to develop aggressively thus increase the level of cheap financing available (Thory, 2008).

As SOEs transition to cell 3, they face increased competition and must use their slack resources in a more efficient way. They need to not only reduce slack stockpiling to improve economic performance, but also must maintain sufficient unabsorbed slack to spur innovation and protect against market downturns. SOEs present an inverse U-shaped relationship between slack and performance, with too

little and too much slack being detrimental (Tan & Peng, 2003). Due to lower spending in R&D by the state, SOEs need to use their slack to spur innovation by engaging in new product experimentation (Liu et al., 2013). Partially privatized SOEs that have a foreign partner are more likely to invest in innovative activities, showing that ownership type in addition to institutional change have an influence on slack resource allocation (Girma, Gong, & Gorg, 2009).

Transitions within the institutional change lifecycle

SOEs in emerging economies in cell 2 have a high level of inertia coupled with a lack of resources. Decision makers focus on short-term gains, fearing the lack and sustainability of political reforms towards market orientation. However, in cells 3 and 4, SOE managers embrace the reforms by making more innovative decisions, taking on a higher level of risk to improve the future of their firms (Tan & Tan, 2005).

The change in institutions has a large impact on the profit-seeking goals of SOEs. Deregulation of previously protected sectors brings in an increased level of competition, where the buildup and stockpiling of high levels of slack, which breed inefficiency, is not feasible (Lin et al., 2001). Changes in the regulatory environment, such as adoption of international accounting practices, introduction of bankruptcy, and liberalization of international investment and trade, result in an increased focus on profitability as the measuring stick used to judge firms; this has an impact on the level and type of slack that SOEs can hold (Cuervo-Cazurra & Dau, 2009).

While cell 2 SOEs are characterized by inefficiency due to their political and social goals coupled with SBCs, as organizational goals shift to emphasize economic performance coupled with a move along their institutional change lifecycle, firm profitability and potential for internally generated slack increase. Although listing on stock exchanges typically contributes to improved corporate governance and may result in improved profitability, politically-connected SOE managers also list their firms internationally in order to gain personal political benefits (Hung et al., 2012). Even though, in cell 3, political goals are phased out by the SOEs' shareholders, their managers may use firm slack to support their own personal objectives. Due to the lower compensation packages of SOE executives, available slack is also used to provide additional perks (*Economist*, 2012).

The institutional changes faced by Chinese SOEs in the last decades exemplify the transitions from cell 2 to cell 4, and then from cell 4 to cell 3. Small SOEs that generated low tax revenue were less likely to survive the restructurings, unlike large SOEs that were maintained as they paid higher taxes, but also because they generated higher slack, thus being able to modernize by reinvesting their profits (Frazier, 2006). Additionally, large SOEs also had available potential slack, which was not available to the smaller privatized firms.

For POEs, their total slack is limited by their own profitability and access to potential sources of financing, as they face hard budget constraints (Kornai et al., 2003). While SOEs may generate lower levels of slack internally compared to POEs, they have other slack resources available due to their association with the state. One such resource, not available to POEs, is the implicit backing by the state in case of financial distress, or SBCs. This potential safety net confers upon SOEs a higher level of trust from financial institutions, which are thus more willing to lend to them,

resulting in higher potential slack (Bourgeois, 1981). Thus for SOEs, slack does not only represent internally generated profits (Tseng, Tansuhaj, Hallagan, & McCullough, 2007), but extends to other resources granted to them by their shareholder, the state.

Depending on the ownership of financial firms, SOEs from different countries have differentiated access to sources of potential slack. In some emerging economies, such as China, SOEs have an advantage in obtaining access to scarce resources, such as bank financing, given that most Chinese banks are state-owned (Song et al., 2011). In other emerging economies in CEE, foreign as well as local POE banks are present and competition within the financial sector is market-based. As a result, efficiently run POEs, which have a lower level of absorbed slack, may have an advantage over SOEs as POEs have a higher level of credibility than some inefficiency-bloated SOEs. However, given state backing, even when SBCs are removed, SOEs can obtain potential slack.

Having the backing of the state, SOEs have a valuable resource, which provides them with an advantage that cannot be easily imitated by private firms. For POEs it is difficult, if not impossible, to find a substitute for such an almost implicit “too big to fail” status. Given the reduction in the total number of SOEs and the increasing importance to the state of the ones that do remain, some of which are deemed national champions, the backing of the state is available. Thus, SOEs have a competitive advantage over their POE rivals due to their special relationship with the state. POEs that do not have the backing of the state and lack access to cheaper and less restrictive loans from SOE banks (such as in the case of China), are therefore at a competitive disadvantage. Therefore:

Proposition 1 SOEs have an economic competitive advantage over POEs, due to SOEs’ access to potential slack and the safety net provided by the state.

Extra employees

SOEs located in economies that have a primary focus on social issues and a secondary focus on economic performance, namely those in cells 2 and 4, are likely to be saddled with higher levels of HR slack. Such SOEs offer their employees a higher level of employment security, but typically a lower potential for career advancement, thus resulting in less motivated employees (Gong & Chang, 2008). During periods of austerity, the state may even force socially focused SOEs to hire additional employees for social protection (Lioukas et al., 1993). Due to their lower level of managerial discretion over firm strategy, SOE executives do not have the flexibility to use this form of slack for productive uses, given that their goals are also set by officials. As a result, due to their historical development, most SOEs in cells 2 and 4 are endowed with an oversupply of labor force.

While excess staff as slack is encountered in POEs as well (Williamson, 1963), in the case of SOEs such employees are not hired and retained at the discretion of the firms’ managers but at the request of the government. While in POEs executives can direct HR slack to experiment with innovative projects, thus spurring entrepreneurial growth from within (Mellahi & Wilkinson, 2010; Wright, Hoskisson, Busenitz, &

Dial, 2000), in SOEs, due to the lower level of managerial discretion, HR slack can have negative consequences. These additional employees can potentially create problems for the firm beyond the cost of paying for their salaries. Such employees, who may be underworked and thus have “too much time on their hands” can resort to destructive behavior, such as theft. The morale of the rest of the employees who observe such behavior can decrease, resulting in feelings of inequity and negative social capital (Kornai, 1992). The slack created by being forced to hire such employees, if they are not engaged in constructive work, can become a competitive disadvantage for SOEs.

In SOEs that have a profit orientation (in cells 1 and 3), the level of excessive HR slack is reduced. SOEs that face market competition streamline their operations and are able to use the HR slack they do have in a productive way. Executives have a higher level of discretion, can determine productive uses for the HR slack that does exist, and can also make reductions when it is excessive. Therefore:

Proposition 2a Human resource slack resulted from the hiring of additional employees for social protection, imposed by the state, constitutes an economic competitive disadvantage for SOEs.

Proposition 2b Human resource slack will positively contribute more to economic performance for profit oriented SOEs in market economies (cells 1 & 3) than in planned economies (cells 2 & 4).

Buffer for the technical core

Slack is a buffer between the firm and external contingencies (Cyert & March, 1963; Thompson, 1967). Firms attempt to protect their technical core from environmental influences by maintaining input and output components, thus ensuring continuity in operations. The margin of error provided by slack can act as a shock absorber to help firms deal with surges in activity (Bourgeois, 1981; Cheng & Kesner, 1997). SOEs in cell 2 are affected by the external environment but do not have much influence over it, due to the planned nature of the economy, with resources and quotas set by state bureaucrats. Thus, firms that hoard resources, even by hiding them from state bureaucrats, are able to ensure continuity in operations despite current input shortages in the markets (Kornai, 1992). Such slack hiding is more prevalent in emerging economies in cell 2 where many SOEs face discontinuous supplies from competing for the same limited resources (Aharoni, 1981). By incorporating unabsorbed slack in the organization, in fact transforming it into absorbed slack, cell 2 SOEs are able to stockpile resources to buffer against environmental fluctuations.

As SOEs face institutional changes by transitioning to cell 4, thus functioning in market economies, they are less likely to excessively stockpile resources. The absorbed slack firms stockpile in cell 2 is typically linked to exploitation activities, being used to buffer the firms’ technical core from supply shortages. However, in cell 4 SOEs face a higher level of competition, and therefore need to also increase their exploration activities. As a result, they reduce the level of absorbed slack, that is mainly linked to exploitation, and build their unabsorbed slack that will be beneficial

in exploration activities (Voss et al., 2008). Due to the higher level of risk presented by exploration activities, SOEs need to maintain their slack in a more easily accessible form (Gupta, Smith, & Shalley, 2006). Unabsorbed slack represents uncommitted resources that are easily deployed (Sharfman et al., 1988; Tan & Peng, 2003), thus being better suited to the riskier, exploratory projects. Therefore, we propose:

Proposition 3a SOEs in cell 2 that stockpile slack resources have an economic competitive advantage compared to SOEs in cell 2 that do not, as they can ensure operation continuity when facing shortages.

The role of slack as a buffer can also have a negative effect on firms, as it can reduce their adaptive response to potential shifts in the environment (Bourgeois & Singh, 1983; Cheng & Kesner, 1997). Instead of providing firms with flexibility to pursue innovative projects, abundant slack can lead to complacency (Nohria & Gulati, 1996). Slack rich organizations may develop a false sense of security and underestimate the need to adapt and develop capabilities needed to succeed in the future (Kraatz & Zajac, 2001). SOEs in cell 2 may appeal to the state in case of emergency, and may fail to adequately prepare for the future as a consequence (Li, Peng, & Macaulay, 2013). Such firms would not emphasize the need to continuously learn and to develop new capabilities that may lead to a sustainable competitive advantage (Leonard-Barton, 1992), and as a result these firms may not be prepared to adequately deal with changes in the environment (Tan, 2003). While on the one hand having absorbed slack would allow SOEs to buffer their technical core, on the other hand having excessive unabsorbed slack would give them a false sense of safety, due to the immediate availability of resources to deal with potential problems. Thus executives become isolated and unresponsive to external demands and fail to adapt to changes in the environment (Thompson, 1967). We propose:

Proposition 3b Excessive unabsorbed slack will have a negative impact on SOEs' economic performance, as it will weaken their strategic response to environmental shifts.

Discussion

Contributions

We contribute to the management literature by analyzing how different categories of slack are related to SOE social and economic performance. Due to their dual organizational goals, which vary depending of the firms' institutional change lifecycle, SOEs have been historically deemed largely inefficient. While this observation may be valid for many SOEs when considering solely economic performance, when we also look at the social performance goals of their state owners, we develop an alternative view.

This article's main contributions are to analyze the likely effects that slack has in SOEs. While previous research has focused mostly on public and private firms operating in market economies, mainly in the United States, our paper focuses on

both developed as well as emerging economies, where SOEs are prevalent. The weak performance of many SOEs from emerging economies has been blamed on their high level of slack that may lead to inefficiency (Kornai, 1992; Peng & Heath, 1996). As most SOEs are based in emerging economies, where environmental uncertainty is higher than in more established economies due to their underdeveloped institutions, unabsorbed slack may be more beneficial in helping firms cope with uncertainty (Meyer, Estrin, Bhaumik, & Peng, 2009; Tan & Peng, 2003). Having slack available helps SOEs deal with unpredictable changes in the highly dynamic markets where they operate. Maintaining unabsorbed slack becomes even more important as SOEs strive to grow and enter international markets, where they face different institutional pressures and strive to increase market share. Competitors' actions, both in their home markets as well as in their newly entered host ones, make it vital for SOEs to have a buffer of unabsorbed slack that will allow them to quickly respond and defend their market position, in case of aggressive action.

While at the outset of the transitions towards market economy occurring both in CEE and China, SOEs were the dominant (and at times sole) competitors, this is not the case anymore as POEs, including foreign-controlled ones, now compete for the same markets (Peng, 2003; Ralston, Terpstra-Tong, Terpstra, Wang, & Egri, 2006). As the owners of SOEs, governments are pushing, with different levels of success, for their reform and move towards profitability. As a result, absorbed slack that bred inefficiency in the past may be reduced, while unabsorbed slack that may become the catalyst for future innovation could be increased.

Overall, we contribute to the management literature by considering the goals of SOEs based on their position on the institutional change lifecycle, as well as their level of profit orientation. We can thus see how the goals of SOEs from planned economies differ from those in market economies, based on their level of profit orientation. We have advocated for an increased focus of institutional change affecting the relationship between slack and performance in SOEs.

Future research should investigate the role played by other environmental factors—such as munificence, dynamism, and complexity (Dess & Beard, 1984)—in the relationship between slack and firm performance. The environmental dynamism caused by institutional transitions influences the rules of the game that govern SOEs behavior and implicitly their use of slack resources, and is especially relevant to firms operating in emerging economies (Peng, 2003). Another aspect to consider is in regard to the measurement of changes in SOE slack over time compared to slack assessment at a specific time (Bourgeois & Singh, 1983; Mosses, 1992).

Future work on the effects of slack in SOEs can benefit from focusing on the role of slack as a predictor of corporate social responsibility (CSR) activities. Welfare states throughout the world have downsized over the past decades and have reduced the resources available to their SOEs to pursue CSR activities. Instead governments have increased pressure on POEs to participate in activities in education, hospitals, and transportation, activities previously often undertaken by SOEs. Given the dual role played by governments as both SOE owner and as institutional regulator, changing the rules of the game in favor of SOEs allows them to generate and keep slack that was previously used for social activities and can lead to an advantage versus POEs (Matten & Crane, 2005; Roper & Schoenberger-Orgad, 2011; Seifert, Morris, & Bartkus, 2004).

Conclusion

Popular opinion in the 1980s and 1990s, when heavy privatization was underway, considered that SOEs were a dying breed that would be relegated to the dustbin of history. However, many SOEs are still going strong. In fact, in crises, even some of the most developed market economies, such as the United States, have resorted to rescuing their “too big to fail” firms by nationalizing them, thus creating new SOEs. Therefore, studying the role that slack resources play in the case of SOEs is a fruitful endeavor (Peng et al., 2013). As markets where SOEs operate become increasingly competitive, SOEs need to understand and use their various forms of slack in an efficient way, as one of their tools in their attempt to become and stay competitive.

Adding to the debate on the relationship between slack and firm performance we show that the focus should not be on whether slack is uniformly good or bad for performance. As SOEs are not all the same and have different organizational goals, by focusing individually on economic and social performance we can have an improved understanding of the effect of different categories of slack on firm performance. By looking at the effect of four different categories of slack on firm economic and social performance, we are able to show how institutional changes influence the allocation of slack resources by various SOEs.

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Ciprian V. Stan (MBA, University of Texas at Dallas) is a PhD candidate in Strategic Management and International Business at the Jindal School of Management, University of Texas at Dallas. His research interests are global strategy, international business, and corporate governance.

Mike W. Peng (PhD, University of Washington) is the Jindal Chair of Global Strategy at the Jindal School of Management, University of Texas at Dallas; a National Science Foundation CAREER Award winner; and a Fellow of the Academy of International Business. His research interests are global strategy, international business, and emerging economies with a focus on the institution-based view.

Garry D. Bruton (PhD, Oklahoma State University) holds the Fehmi Zeko Faculty Fellowship at the Neeley School of Business, Texas Christian University. He also holds the position of Honorary Professor, Department of Business Administration at Sun Yat-sen Business School (SYSBS), China. His research interests are entrepreneurship and international business with a focus on emerging economies.