

## Strategic Management Theory in a Post-Pandemic and Non-Ergodic World

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*From time to time, organizational environments undergo cataclysmic upheavals – changes so sudden and extensive that they alter the trajectories of entire industries, overwhelm the adaptive capacities of resilient organizations, and surpass the comprehension of seasoned managers. (Meyer et al., 1990, p. 93)*

This quote, written 30 years ago, describes the pandemic environment in which the world exists today. As Meyer et al. (1990) explained, such quantum discontinuous changes require entrepreneurial responses. In the ongoing Covid-19 pandemic, firms must devise strategies to deal with short-term discontinuities and significant uncertainty to survive. After the pandemic eases, longer-term strategic changes may be needed to navigate the competitive landscape arising in the ‘New Normal’ which has resulted from technological, socio-political, and institutional changes (Ahlstrom et al., 2020) that resemble the causes of environmental jolts explained by Meyer et al. (1990). This New Normal is unlikely to be a static equilibrium, because the pandemic shock has triggered another unexpected dynamic. As Nobel Laureate Douglass North (1999) explained, we now exist in a non-ergodic world in which the new equilibrium after major disruptions continues to change thereafter, similar to dynamic equilibria in open systems. Thus, firms need new and more flexible strategies to achieve what North described as adaptive efficiency. While it is unclear which changes caused by the pandemic will persist, it seems evident that certain aspects of the business environment will change with the current crisis serving as a tipping point. Hence, this new environment (during the pandemic and thereafter) begs the question ‘How does strategic management theory help us understand how firms

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can navigate the New Normal?'. We examine two main strategic management theories prominent in the field for the last three decades – resource-based theory and agency theory – in light of the opportunities and challenges likely to emerge in the non-ergodic New Normal environment, and comment on implications for strategic management more broadly.

### **Resource-Based Theory**

We begin with one of strategic management's most influential theoretical perspectives, resource-based theory (RBT). Although the disruption has been more significant for some firms and industries than others, firm resources are critical for surviving the pandemic and the resulting economic disruption. In the short term, financial resources are needed for survival. Because of the lockdowns and severe recession, many firms suffered severe declines in revenue and as a result, experienced significant cash-flow problems. Thus, they have had to deplete cash reserves or access cash from other sources (e.g., leverage and/or the sale of assets) to remain solvent. For many firms, survival (i.e., existing competitive advantage and its value appropriation) has become a more pressing concern than long-term sustainable competitive advantage from valuable, rare, inimitable, and non-substitutable (VRIN) resources. This short-term shift in priorities has been strengthened by the threat-rigidity effect, which suggests that firms respond to challenges by curtailing new innovation and narrowing their focus to what has worked in the past (Staw et al., 1981). As a result, many firms have curtailed risk taking and reduced their focus on long-term strategic commitments in favour of short-term objectives, primarily focusing on survival.

Yet, firms also must prepare for the New Normal environment that will ensue in the post-pandemic period. Many firms have shown an ability to adapt to the pandemic in the short term, but they likely will require different resources and new ways to use them in the long term. Thus, resource orchestration takes on added importance. Firms may require more flexible resources and new capabilities to compete in the new environment which includes a rapidly changing competitive landscape. Firms may need to focus less on resource attributes (VRIN) and more on routines and processes that allow them to reconfigure resources and capabilities to operate effectively in the new environment, in order to achieve the adaptive efficiency envisioned by North (1999). Commonly, routines evolve over time as firms learn what is needed to adapt. However, when environmental jolts and disruptions occur, routines also must change quickly to allow firms to acquire/develop new resources and bundle them to create new capabilities rapidly (Sirmon et al., 2007, 2011). Thus, firms must possess or rapidly develop dynamic capabilities to manage their resources more flexibly and effectively (Eisenhardt and Martin, 2000; Teece, 2007).

Fixed assets, especially those that are location bound, historically have been viewed as a source of competitive advantage. However, these assets are difficult to redeploy for alternative uses. Some firms may need to obtain more liquid and adaptable resources, which can support the reconfiguration of other resources. As one example, the stock of expensive office space, stores, or market-seeking resources that firms have developed over decades may be less essential or may become a liability in the pandemic and post-pandemic environment, as employees and customers become increasingly willing and able to perform activities (e.g., work and make purchases) remotely. Because intangible

resources often are more flexible, they likely will take on added importance. Technology and human capital are perhaps the most critical resources on which redeployment and reconfiguration efforts depend. Thus, they may be critical for creating new capabilities to deal with the expected uncertainty in the New Normal environment. For example, Rindova and Courtney (2020) argued that firms can develop adaptive strategies or shaping strategies to deal with uncertainty. Whereas adaptive strategies help firms to identify attributes of uncertain markets and environments and to design ways to respond, shaping strategies help firms identify opportunities created by the uncertainties and exploit them proactively (Eisenhardt, in press). Ironically, although firms must innovate to compete in the New Normal environment, the economic recession and decline in the collocation of human capital (e.g., due to the increase in remote workers) has made innovation more difficult. Thus, although shaping strategies might be more important in the longer term, they also are more challenging and riskier. These observations suggest the following potential research questions:

1. How do firms develop dynamic capabilities that allow them to change their resources and capabilities rapidly in the New Normal environment?
2. How do firms avoid inertial tendencies and attempt to reduce their exposure to risks during major and difficult-to-foresee economic disruptions?
3. Which firms earn higher returns over the longer term: those that engage in adaptive strategies or those that engage in shaping strategies during major economic disruptions?
4. How might firms facilitate innovation, an activity often viewed as location bound, to a remote work environment?

## **Agency Theory**

Agency theory's primary focus is the relationship between principals and agents. Agents sometimes act in their own interests rather than in principals' interests. Most agency theory arguments centre on actions to maximize shareholder (principal) value (Keum, 2020). One issue of debate, even before the pandemic, was short-term versus long-term value. Some management scholars have been critical of firms emphasizing short-term financial returns over long-term value (Porter and Kramer, 2011). The pandemic has highlighted the debate because many firms chose to focus on survival in the short term, yet, they still face pressures to identify different strategies to succeed in the long term. Due to the uncertainty caused by the pandemic, ensuring that managers (agents) emphasize owners' interests has become more critical yet also challenging, because resources are scarce, firm survival is threatened, and some managers' jobs are at risk. Moreover, most owners and managers lack experience with events like the pandemic, which makes it more difficult for them to identify strategic decisions and actions that maximize shareholder value. The usual cognitive processes and heuristics to achieve and evaluate this outcome may be less effective due to the unprecedented disruption.

Although concern for non-owner stakeholders, such as customers, employees, and the community, has increased recently, the pandemic has heightened this concern. The economic disruption has harmed some of them severely, creating new questions about and focusing more attention on firms' responsibilities to these stakeholders. As a result, stakeholder theory is likely to be more important in the post-pandemic period and may

serve as a critical complement to agency theory. Shareholders' short-term returns may be less important than preserving the firm's reputation and integrity and taking actions that protect the firm's potential to create value in the long term, especially in the New Normal environment. Consistent with this view, Barney (2018) argued that treating shareholders as the firm's only residual claimants is inconsistent with RBT's logic on profit appropriation. He argued that non-owner stakeholders must receive value before the shareholders, because the support of such stakeholders is necessary to create value in the first place. These arguments challenge historical emphasis in agency theory research on executives and shareholders to the exclusion of other stakeholders. Moreover, Barney and Mackey (in press) argued that stakeholders should be viewed as complementors because more value is created when they work together than when they work separately. Thus, like these scholars, we recommend integrating stakeholder theory more thoroughly into theories of the firm.

The notion of multiple stakeholders as residual claimants strongly influences the application of agency theory because all important stakeholders can be viewed as principals each with different claims (McGahan, 2020). This discussion also shows that RBT and agency theory are linked, especially through the appropriation of profits. These observations suggest the following potential research questions:

1. Why has the pandemic harmed some stakeholders more than others? How can managers respond effectively to these effects and mitigate them in the future?
2. How do managers build and maintain relationships with multiple principals that make different claims on firms?
3. With multiple stakeholder principals, how do managers determine the appropriate distribution of value to each of those principals?

### **Managing Strategically in a Post-Pandemic and Non-Ergodic World**

The post-pandemic non-ergodic New Normal likely will continue to create significant complexity and uncertainty for managers. It may reveal boundary conditions for RBT, agency theory, and perhaps other theories (e.g., those emanating from industrial organization economics; Porter, 1980) that help us understand and explain firm behaviours and performance. More broadly, to address the substantial changes occurring, firms must adapt to or shape their environments by identifying, creating, and exploiting opportunities. The extension to and heavier emphasis on resource orchestration, rather than specific resource attributes, illustrates an outcome of these boundary conditions. Likewise, the complexity and uncertainty may reduce the value of single-purpose theories, such as agency theory, and heighten the value of more systemic theories, such as stakeholder theory. Along these lines, Harrison (2020) argued that understanding value creation in this new non-ergodic world requires the integration of theories that explain systems, resources, and stakeholders. And, recently, Hitt et al. (2020) found that firms within dynamic, uncertain environments were more willing to engage in riskier entrepreneurial strategies (e.g., shaping) versus more incremental advantage-based strategies (e.g., adapting) when they had developed strong relational capital with important stakeholders.

Organizational hybridity, which is an integration of different strategies, logics, and structural forms (e.g., structural flexibility) to manage complex problems, may be

required to manage resources and stakeholders more effectively in the post-pandemic era. Additionally, firms need the agility to design and implement strategic changes effectively, which requires fluidity, speed, and mindsets that encourage innovative thinking and resilience. Thus, the sensing, seizing, and transforming components of dynamic capabilities (Teece, 2007) are even more complex in this New Normal environment. These efforts depend importantly on the skills of firms' managers (dynamic managerial capabilities – Adner and Helfat, 2003). And, while top executives have similar levels of cognitive capabilities (Hitt and Tyler, 1991), developing and leveraging new dynamic capabilities also require harnessing the cognitive and emotional skills of the top management team and other critical stakeholders inside and outside the firm (Hodgkinson and Healey, 2011). The substantial uncertainty and increasing emphasis on stakeholders as principals require supra-dynamic managerial capabilities to create organizational hybridity and to manage the complex resource acquisition, and organizational capability development processes (i.e., resource orchestration) needed to agilely design and implement innovative strategic changes in the New Normal non-ergodic world.

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