

**MANAGING CORE COMPETENCIES in a VOLATILE
EXCHANGE RATE ENVIRONMENT**

By

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Abstract

Recent events affecting some South East Asian economies portray the turbulence to which national economies are now subject in the world economic environment. How do firms maintain the competencies required for long term success? This study examines aspects of the relationship between short term economic turbulence and the development and maintenance of existing core competencies.

Introduction

Recent events affecting some South East Asian economies

demonstrate the turbulence to which economies are now subject in the present world economic environment. This is particularly true regarding high degrees of exchange rates volatility. How do firms maintain the competencies required for long term success? This paper examines the relationship between exchange rate turbulence, the maintenance of existing core competencies and the development of new core competencies.

CORE COMPETENCIES

The management of core competencies is one of the

most important strategic challenges facing a firm given their crucial relationship to superior profitability. Once created, core competencies cannot be simply stockpiled for use when needed. Rather, these core competencies require constant use to maintain corporate fitness (Teece, 1990). Thus firms wherever situated and in whatever circumstances must view the management of these core competencies as an important strategic issue.

The strategic management of core competencies not only requires investment in existing competencies but also the acquisition and development of new ones. Consequently, one of a firm's key issues in maintaining corporate competitive advantage involves striking the proper balance between these activities.

Whatever this balance, investment in future capabilities must always continue. Often the search for solutions to present problems is in fact a strategic plan of action to develop new core competencies.

STATIC AND DYNAMIC PERSPECTIVES

Sanchez & Thomas(1996) support the importance of the

distinction between the static and dynamic perspectives regarding core competencies by suggesting that managing the building of core competencies may be a task which is intrinsically different from managing the leveraging of existing ones. Consequently, different types of managers may be required for these two distinct tasks (Hitt & Tyler, 1991). Competition and non-industry environmental factors contribute to the dynamic nature of a firm's environment and hence to the value of dynamic representations of core competencies. Due to industry or environmental changes, core competencies in one context or historical era may not remain as such in another. This may be true of some ASEAN economies to the extent that the skills for success have changed as a direct function of that very success.

Unique historical conditions, causal ambiguity, and social complexity, contribute to changing firm strategies (Lippman and Rumelt, 1982; Reed and DeFillippi, 1990; Mahoney and Winter, 1996). Due to their flexibility, intangible resources and capabilities are most likely to have adaptive characteristics in turbulent environments. Tangible resources are also important but it is the changing

application of these resources to new conditions which drive profitability and in some cases, survival.

The appropriate application of either static or dynamic perspectives of core competencies depend on conditions facing the firm. Both perspectives give insight, their differing emphasis a reflection of the competing objectives of striking a proper balance between the development of new competencies and the improvement of existing ones (Penrose, 1959; Wernerfelt, 1984). The balance between 'present and future' is reflected in the firm's level of organizational flexibility.

TURBULENT FOREIGN EXCHANGE MARKETS

In the present global economic order international trade is increasingly important in fueling the economic growth of firms, countries, and entire geopolitical spheres. This is particularly true for developing economies dependent on the existing markets of the industrialized world.

To the degree to which foreign exchange rates are constant, change slowly, or predictably, difficulties due to fluctuations in currency exchange are minimized.

Difficulties are encountered however when these markets

are manipulated or otherwise unduly chaotic.

FOREIGN EXCHANGE RISK EXPOSURE

Given the present liquidity of foreign exchange markets the desire to rapidly change the composition of foreign denominated asset portfolios may cause massive changes in the demand for currencies unrelated to the long-term economic fundamentals of those currencies home countries. This type of volatility may bear no relationship to anything other than offshore asset allocation decisions.

Firms vary tremendously in the impact of currency exchange rates fluctuations on their present and potential profitability. At one extreme firms with both assets and liabilities denominated in the same currency have little risk. At the other extreme firms whose assets and liabilities entirely denominated in different currencies are at greater risk.

To analyze the effect of volatile exchange rates on an individual firms performance strategic managers must realize that there are many internal factors which are important. While firms cannot generally affect foreign exchange markets themselves they may be able to influence the effect of those

markets on firm profitability and viability.

Treasury functions of corporations must do more than simply manage direct currency risk, they must also devolve their expertise to the operating unit level as capabilities to deal with currency volatility must become firm wide. Similarly, information must ascend from operating units to treasury to coordinate firm wide currency exposure and flexibility.

STRATEGIC RESPONSES TO THE PRESENT ENVIRONMENT

Firms in nations with a recent history of high exchange rate volatility may find themselves in a precarious dilemma. Short term economic considerations make the efficient rationalization of resources imperative for survival. This can result in the gutting of intangible capabilities in favor of the preservation of tangible ones.

The maintenance and development of core competencies still remains crucial in the present environment. World technological trajectories remain unaffected by localized currency volatility. Firms located and doing business in unaffected nations operate unabated. It simply is not a long term option for firms located in affected Asian economies to

abandon development of core competencies. To do so would cede a perpetual competitive advantage to firms located elsewhere.

The issue is one of managing currency volatility in such a way that it does not materially interfere with a firm's global competitiveness. This can only be accomplished by maintaining and developing core competencies under all circumstances, even under duress.

A solution to this conundrum is partially reached through the realization that core competencies being knowledge based do not interfere with recovery from economic setbacks, they aid in the process.

This line of logic is in fact a single application of a broader theme: core competencies cannot be sacrificed to temporary economic setbacks. Core competencies not only support future competitive advantage they are *required* for long term firm survival. To abdicate the maintenance and development of core competencies is tantamount to surrender and is appropriate only in harvest strategies.

This paper has already suggested some responses to the volatile exchange rate regimes. Firms must understand their exposure in a sophisticated manner. Knowledge regarding the

impact of currency depreciation or appreciation must be integral to all levels of organizations based or doing business in non-reserve currency nations¹. This is particularly true for rapidly developing economies subject to the vagaries of foreign capital investment.

Distribution channels and market structure may be affected in these circumstances. Firms must *imagine* and plan for these effects. An awareness of what drives local markets and the effect of external forces is important.

Recent high real estate appreciation in many ASEAN nations reflected portfolio decisions made by investors in America and Europe rather than local economic considerations. Local currencies were artificially high because of foreign demand for assets denominated in them. Although the policies of national governments may have contributed to the problem, when demand for new assets abruptly fell off the result were preordained.

Managers must evaluate the reasons behind the demand

¹ Firms based in hard currency nations are not immune to the vagaries of currency fluctuations. This is particularly true if they have important markets in nations subject to these extreme volatility. Nonetheless hard currency fluctuations are generally less extreme and occur over a longer time period, thus being less problematical.

for their currencies. Care must be taken in situations where foreign portfolio decisions drive asset and currency values. Predictably, once foreign investors have arrived at their preferred exposure levels then demand for the local currency will fall off. This is a particular problem for relatively small economies as they are more vulnerable to smaller scale portfolio changes. It is important to note that portfolio disinvestment is not required for currencies to tumble, simply a significant drop in *new* investment.

While we prefer stability we should not view it as an end in and of itself. There are numerous examples of economies which have relatively stable exchange rates and are going nowhere with little international investment interest. Sometimes the fact that nothing is changing means nothing is happening.

Many developing economies have used Japan's export driven model as their orientation.

High domestic savings rates offer no relief from currency fluctuations and may actually be counterproductive in periods of high capital inflows from outside the country. It is certainly true that contractionary fiscal and/or monetary policy is not an appropriate response in this

situation. It merely aggravates the problem since excess domestic demand *was never the issue in the first place*. In fact there is every reason to believe that stimulating the economy would be of greater value².

In any event, strategic managers must understand the manner in which these dynamics play out. National governments and transnational organizations make decisions affecting the business environment and firms must be prepared to deal with these decisions, ill-conceived or not.

CONCLUSION

² Measures to convert savings into demand are appropriate.

The recent buffeting of economies in Asia has presented managers³ with difficult strategic decisions. This paper has indicated that the continued maintenance and development of core competencies remains essential. The development of a sophisticated manner in which to approach exchange rate volatility is also called for.

Exposure to fluctuating exchange rates is specific to each firm and must be dealt with uniquely. Awareness of this strategic issue must permeate the firm at all levels. Managing currency risk is not the exclusive responsibility of treasury. It must be shared with operations as well.

It will be interesting to see how firms in countries adversely affected by recent exchange rate volatility fare. Undoubtedly some will fail, but others will prosper and those skills developed in response to the present environment may portend competitive advantage in the future.

³ And governments.

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