

# The Impact Of Potential Absorptive Capacity On Strategic Flexibility Through Organizational Unlearning Under The Influence Of Environmental Dynamism

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## Abstract:

*The study talks about strategic flexibility antecedent and mechanism to add the the body of knowledge for research community. Environment of the business is changing continuously which is evident by rapid change in demands of customers, change in government policies and rapid shifting of competitor's strategies which encourages companies to keep shifting their strategies to be aligned with environment. In order to achieve this organization continuously acquire knowledge through potential absorptive capacity. <sup>1</sup>There are certain existing habits, knowledge and beliefs which need to be updated through the process of unlearning in order to use newly acquired knowledge so that company can be flexible in its strategies as old and obsolete knowledge create rigidity. Environmental dynamism acts as moderator between potential absorptive capacity and strategic flexibility. Data is collected from 300 pharmaceutical firms in Pakistan and analysis through smart pls. Findings show that potential absorptive capacity has positive effect on strategic flexibility whereas organizational unlearning positively mediates the relationship. Environmental dynamism positively moderates the relationship between potential absorptive capacity and strategic flexibility. The paper ends with discussion and future avenues.*

## Introduction:

Absorptive capacity is a concept used by the researcher to deal with handle rapidly changing environment ((Posen & Levinthal.,2012; Stieglitzitz, Knudsen, & Becker.,2016) especially in the area of strategic management. Organizations also change due to another component which is called strategic flexibility where organizations bring flexibility in their strategies to deal with changing environment. Strategic flexibility is capacity of firm to sense the environment before and identify the problems beforehand(proactive) or respond to the problem once its occurred(reactive) (Sen.,2022; Sanchez.,1995; Volberda.,2002). Researchers of strategic management, marketing, management and entrepreneurship discuss strategic flexibility but the research on its antecedents, contingencies and mechanism is lacking. This study focuses on strategic flexibility and how it is created through acquiring of knowledge by potential absorptive capacity and removing rigidities created by existing knowledge and beliefs through organizational unlearning which is discarding of old knowledge with the intention of learning something new. Environment dynamism which is changes and uncertainty in the environment positively moderates the relationship between potential absorptive capacity and strategic flexibility.

## Absorptive Capacity:

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It is an ability of the firm to obtain, assimilate, transform and exploit knowledge acquired to deal with ambiguity in the environment (Zahra & George,2002). Zou et al (2018) were of the view that absorptive capacity is an ability of a firm to determine the importance of external knowledge and used the knowledge for the benefits of organization. Absorptive capacity does only create innovation but also help organization for collaborating with other organizations, increasing organizational learning and developing entrepreneurship (Lia et al.,2003).

Absorptive capacity has three types of antecedents discussed in the research namely managerial antecedents where managers monitor outside information from the environment. Absorptive capacity can also be generated through intra organizational antecedent when members of the firm interact with each other (Tarsen et al.,2005). Third antecedents are interorganizational where organizations learn from its competitors. (Marruci et al.,2022)

Outcomes of absorptive capacity are various dimension of learnings and capability creation. It is a higher order capability which leads to other capability to align with the environment and internally adjust resources. (Dzbenigiz,2020). Considering this fact, the given study generates strategic flexibility through internally modifying existing belief through organizational unlearning.

Absorptive capacity has two types namely potential and realized absorptive capacity. Potential absorptive capacity is acquiring and assimilation of knowledge whereas realized absorptive capacity is transformation and exploitation of that knowledge (Zahra and George,2002).

#### **Potential absorptive capacity:**

Hurtado-Palomino et al (2022) were of the view that potential absorptive capacity is an ability of a firm to obtain knowledge form external environment and make it a part of the organization which is called assimilation. Assimilation occurs when firms understands and make a sense of externally acquired knowledge. When firm obtain knowledge from external environment, it increases the knowledge base in the firm (Zamora et al.,2021) for instance when organization works with other organizations e.g. its supplier, it learns new way of doing business (Porter & Hepplemann,2015).

Knowledge based view encourages knowledge acquisition because this is the only way to get competitive advantage (Matar & Rauelinuniene,2021). Getting knowledge from external environment is very crucial for organization to survive because of rapidly changing environment (Rodriguez et al.,2014). Due to advent of new technology, acquiring of knowledge become easy in modern world. Firm can use this knowledge by replacing old knowledge in subsequent stages. Assimilation is part of potential absorptive capacity where the acquired knowledge is integrated and incorporated into the organization. It becomes part of organization through sharing with its members. Organization should be good at this ability of integrating. It should be skilled at aligning new knowledge with existing knowledge. Organization should also be flexible enough to update the knowledge and modify the existing knowledge where required. This encourages this study because potential absorptive capacity also evaluates the knowledge and update it by discarding older one.

#### **Organizational unlearning:**

Xi et al (2020) were of the view that when organization starts removing older knowledge, belief and habits in order to replace new ones. Organization environment is always changing e.g. customers' demands are changing continuously, governments are changing their policies drastically and competitors are coming up with new products. These changes encourage organizations to discard older knowledge and replace it with new one because

older knowledge creates rigidities which prevent organization from changing its path (Grisold, 2017).

Removal of existing knowledge creates a space for new knowledge to take its place (Lye et al., 2020). Organizational unlearning is only way to go for change. It requires the firm to do something different than before (Colombo et al., 2017). Firm should discover those behaviour and knowledge which are preventing it from change and start discarding them (Lye et al., 2021).

Organization will lose many opportunities if it keeps working in the same way in which it is operating in past. It needs to develop new ways of doing things which is not possible without unlearning (Kavanagh, 2015). If firm wants to achieve something new, it needs to develop the skill unlearning because unlearning remove path dependency and help organization know different and new ways of doing business (Cepeda-Carrion et al., 2012).

### **Strategic flexibility:**

As firm's environment is continuously changing, it needs to develop skill to shifting their strategies continuously to adjust itself to the environment. This adjustment and modification of strategies is called strategic flexibility (Bashir, 2023). Sen et al (2022) were of the view that organization should have an ability to adapt itself to the changing environment.

Strategic flexibility helps the firm to identify any changes in external environment and then change itself by internally modifying resources. This is reactiveness of a firm (Brozovic, 2021). The construct is made up of two-word strategy and flexibility. It was used in management for the first time in 1957. Flexibility is opposite of status quo. (Volberda, 1996; De Hann et al., 2011).

There are three types of environmental changes namely operational, competitive and strategic and flexibility has also three types i.e. operational flexibility, competitive flexibility and strategic flexibility (Eppink, 1978). If organization needs to align to culture, technology and politics of the country in which it is operating, it has no choice but to develop strategic flexibility (Zhou & Wu, 2010).

### **Environmental Dynamism:**

Dynamism is when there is uncertainty in the environment, it is environmental dynamism (Yawson, 2020). According to Kumar and Bhatia (2021), dynamism is when there are changes in customer demands, fluctuations in prices of raw materials of supplier and aggressive introduction of products or services by the competitors. This kind of environment is not stable and is said to have dynamism.

Organization working in environment which is stable and predictable like government institutions, school and university etc., they can rely on previous knowledge but if the environment is rapidly like that of IT industry, rely on past knowledge is not going to work (Samba et al., 2020).

### **Hypothesis Development**

#### **Potential absorptive capacity and Strategic flexibility:**

Potential absorptive capacity is acquiring and assimilation of knowledge. Due to this organization determine changes in the environment and bring in this changed knowledge into the organization which subsequently help organization to change its strategies or modify them to deal with changing environment (Miroshnychenko et al., 2021) and this changing or modifying strategies is called strategic flexibility. Competitive advantage is increased by potential absorptive capacity because firms are continuously changing to adjust to the environment (Foss & Lyles, 2010).

Those organizations showing capability to use their resources in different combination to achieve its objectives come through carefully obtaining external knowledge (Zahra & George,2002). Miroshnchenko et al (2021) were of the view that if firm wants to make new products and innovates its processes, it has to develop a good capability of acquiring and assimilating knowledge. Flexible deployment of resources is only possible if firm is proactive and acquiring external changing knowledge otherwise it's not possible.

Above discussion leads to following first hypothesis of the study

H1: Potential absorptive capacity increases strategic flexibility

### **Relationship of Organizational unlearning with potential absorptive capacity and strategic flexibility**

One of the most important resource is knowledge. New knowledge creates problem or confusion when it is not fit with existing knowledge. In order to create a comfortable state, there must be some mechanism where older knowledge gets replaced by the new (Rubberneck & Sirec,2007).

In some cases, the new knowledge earned is aligned with previous knowledge, in this case there is no need to update the knowledge but in most cases, exiting knowledge needs to updated in order to align with changing environment (Mitchell & Sacknety,2000). Potential absorptive capacity has an ability to evaluate the knowledge coming in the organizations. It evaluates what kind of knowledge is coming in the organization. Is it aligned with older knowledge or this knowledge needs the older one to be replaced, so potential absorptive capacity has an ability to reflect upon instead of just acquiring the external knowledge (Zahra and George,2002). The knowledge obtained and passed through the process of unlearning is useful knowledge because obsolete knowledge is replaced in the process of organizational unlearning. This new knowledge helps the firm to do something new by reconfiguring resources which is the essence of strategic flexibility. Old knowledge and routines creates rigidities which prevent the firm to do differently than past and firm becomes dependent on this previous knowledge. Organizational unlearning makes a firm independent of this old knowledge by updating it and this updated knowledge can be used to shifting strategies according to new knowledge (Belonging & Jenkins,2003).

According to Wensley & Navarro (2015), if organization wants to convert what is acquired rapidly changing environment into action, it must go through unlearning process to update the knowledge because previous knowledge prevents it from innovating by reconfiguring resources. Potential absorptive capacity put pressure on the firm to be flexible by unlearning old habits, beliefs and behaviours because it is a need of changing environment in which company is operating (Griswold et al.,2017).

Organizational unlearning mechanism helps the firm to get rid of 'Ostrich effect' and face the environment by it recognizes that organization need to change by discarding old knowledge and replacing it with new one which increases firm ability to operating differently that it did in the past thereby modifying its strategies to meet its rapidly changing environmental needs (Sen et al.,2022).

Above discussion leads to following hypothesis of the study

H2: Potential absorptive capacity increases organizational unlearning

H3: Organizational unlearning increases strategic flexibility

H4: Organizational unlearning positively mediates the relationship between potential absorptive capacity and strategic flexibility.

### **Moderation of Environmental dynamism between potential absorptive capacity and Strategic flexibility:**

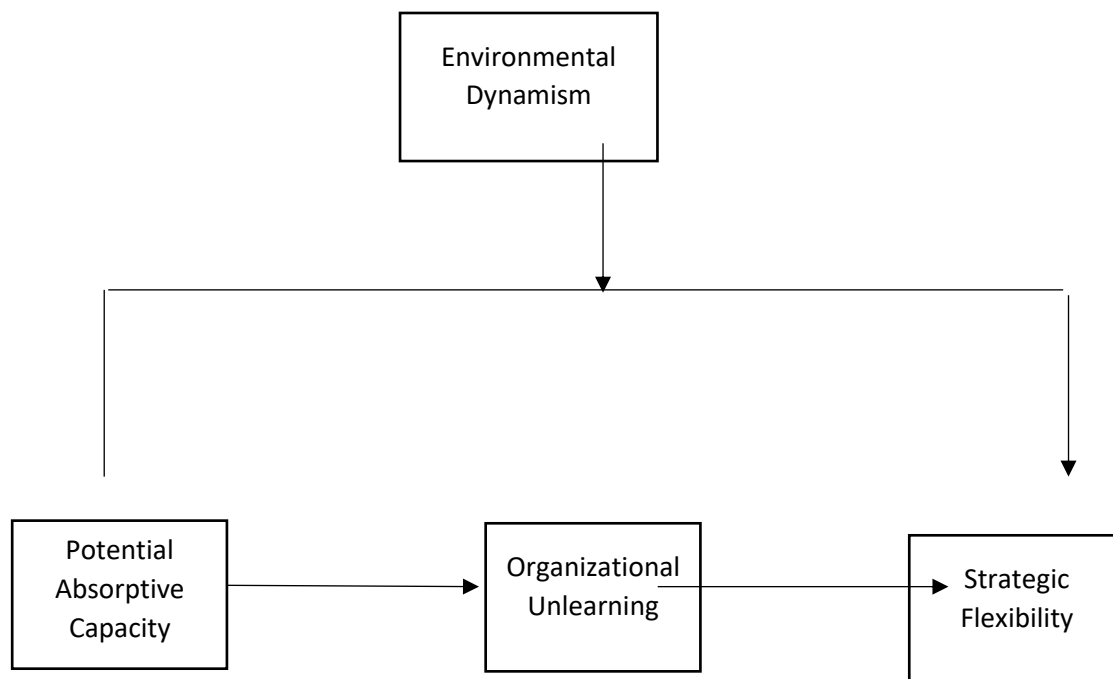
Zhang (2006) was of the view that firm operating in rapidly changing environment develop strategic flexibility because they have no choice as demand of its customers is changing, supplier is changing its prices and competitors are shifting their strategies. According to Yawson (2020), firms adopts different options to remain competitive in uncertain environment.

Dynamism in the environment encourages the firm to acquire new knowledge because without getting the knowledge of environment which is changing rapidly, no firm can survive. Potential absorptive capacity is an exploratory learning which help firms to explore new knowledge to remain competitive by using this knowledge to reconfigure resources to generate something new. It helps to come out of competency trap (Teece et al.,1997).

It is also proposed by dynamic capability theory that organizations operating in dynamic environment seek new knowledge through exploratory nature of potential absorptive capacity as old knowledge is not going to serve and this new knowledge help organizations to adopt alternative strategies(Hung & chou,2013).Mura et al(2014) were of the view that if company's environment is stable, it can use old and existing knowledge because it can serve the firm better but dynamic environment compels the organization to look for new knowledge so that it can be exploited to remain competitive through strategic flexibility.

Above considering lead to fifth hypothesis i.e.

H5: Environmental dynamism positively moderates the relationship between potential absorptive capacity and strategic flexibility.



### Methodology:

The population for this study is pharmaceutical companies of Pakistan. There are 969 companies on the website of DRAP (Drug Regulatory Authority of Pakistan). knowledge intensive nature of these firm make them perfect candidate for this study. It is rapid growing economic sector of Pakistan because of links with other institutions. This industry works with its supplier for Research and Development activities (Ramy et al.,2022) It is a regulated industry but because of changing happening in the industry, it needs to meet challenges by being flexible.

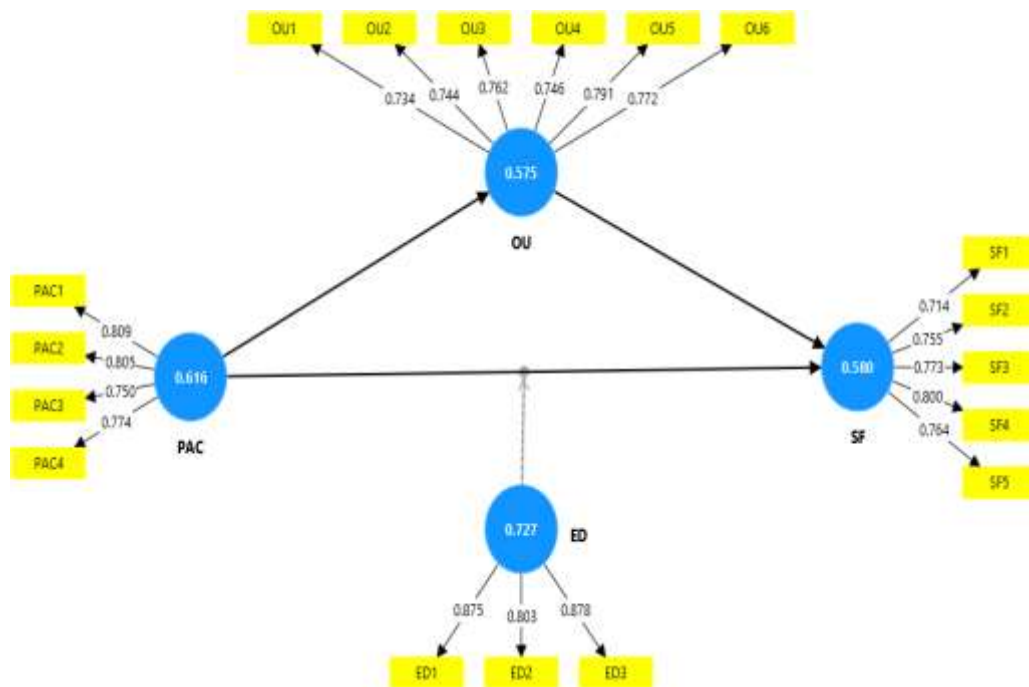
Out of 969 companies, 300 companies are chosen for this research. Stratified random sampling is used as sampling techniques because these firms are divided into four provinces of Pakistan namely Punjab, Khyber Pakhtunkhwa, Sindh and Balochistan. In this study adopted scales are used. Potential absorptive capacity is measured by scale used by Nguyen et al., 2021. Organizational Unlearning is measured by scale used by Zhang et al., 2021. Strategic flexibility is measured by scale adopted by Grewal & Tanshaj (2001) and Environmental dynamism is measured by Hernandez-Linares et al (2018).

**Results, Discussion and Conclusion**

**Measurement Model:**

The shows that all values of measurement model (Table 1) are full filling the criteria. The reliability of all construct which is measured by Cronbach’s alpha is higher than 0.7. Average variance extracted (AVE) is more than threshold value of 0.5 (Hair et al., 2019). HTMT ratio (Table 2) is also less than 0.9 (Henseler et al., 2015) which indicate discriminant validity. Discriminant validity is also proved according to Fornell Larcker criteria as shown in Table 3.

**Confirmatory Factor Analysis**



**Factor Loadings**

**Table 1**

	Outer loadings	Cronbach's alpha	Composite reliability (rho_a)	Composite reliability (rho_c)	Average variance extracted (AVE)
PAC1	0.809	0.792	0.797	0.865	0.616
PAC2	0.805				
PAC3	0.750				
PAC4	0.774				

OU1	0.734	0.852	0.853	0.890	0.575
OU2	0.744				
OU3	0.762				
OU4	0.746				
OU5	0.791				
OU6	0.772				
ED1	0.875	0.813	0.829	0.889	0.727
ED2	0.803				
ED3	0.878				
SF1	0.714	0.819	0.825	0.873	0.580
SF2	0.755				
SF3	0.773				
SF4	0.800				
SF5	0.764				

#### HTMT Ratios

**Table 2**

	PAC	OU	ED	SF
PAC				
OU	0.549			
ED	0.351	0.301		
SF	0.631	0.597	0.533	

#### Correlations (Fornell Larcker Criteria)

**Table 3**

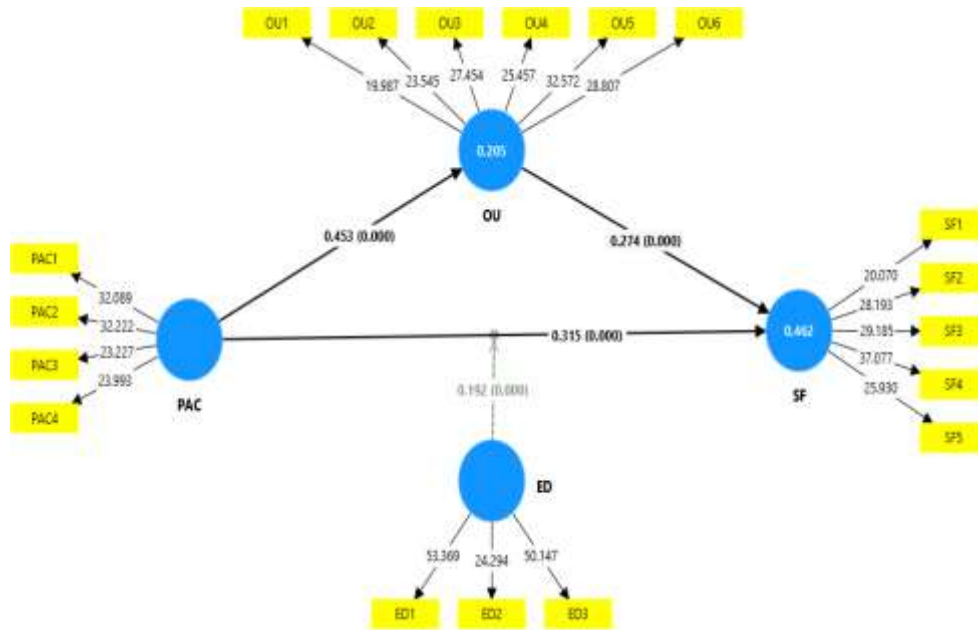
	PAC	OU	ED	SF
PAC	<b>0.785</b>			
OU	0.453	<b>0.758</b>		
ED	0.284	0.254	<b>0.853</b>	
SF	0.515	0.501	0.442	<b>0.762</b>

#### Model Fit Indices

	Saturated model	Estimated model
SRMR	0.060	0.065
d_ULS	0.607	0.722
d_G	0.198	0.198
Chi-square	333.646	330.439
NFI	0.839	0.840

Structural Model:

Direct effects are given in table 4 and indirect mediation effects are given in table 5.



	$\beta$	STD-DEV	T stat	P values	VIF	f-square	R-square
ED -> SF	0.275	0.051	5.358	0.000	1.113	0.126	
OU -> SF	0.274	0.052	5.264	0.000	1.295	0.108	<b>OU = 0.205</b>
PAC -> OU	0.453	0.051	8.917	0.000	1.000	0.259	
PAC -> SF	0.315	0.056	5.646	0.000	1.314	0.140	
ED x PAC -> SF	0.192	0.045	4.294	0.000	1.010	0.066	<b>SF = 0.462</b>

Table 4

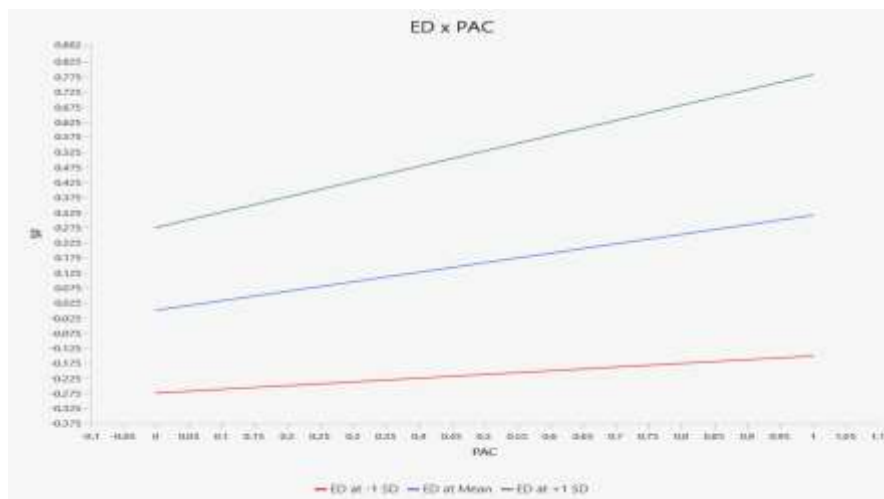
Specific Indirect Effects for Mediation

Table 5

	$\beta$	STD-DEV	T stat	P values
PAC -> OU -> SF	0.124	0.025	4.915	0.000

Moderation Graph





As knowledge is changing with change in environment. It needs to be updated. This study indicates that obsolete knowledge is first unlearned or replaced to allow organizations to be strategically flexible. If new knowledge is aligned with previous knowledge, then potential absorptive capacity increases strategic flexibility. So H1 is proved. When firm identifies new knowledge in the environment, it forces it to unlearn old knowledge to replace it with new knowledge. Potential absorptive capacity creates Ba which is suggested by Nonaka(2000).so H2 is also supported (Grisold et al.,2017). The unlearned knowledge is useless if it is not use to modify the strategies to align with the environment. This knowledge creates strategic flexibility. Old knowledge creates a barrier for the organization to modify the strategies and hinder new knowledge(Klammer,2024 In this study, this barrier is reducing by organizational unlearning and potential absorptive capacity lead to strategic flexibility through organizational unlearning. This confirms H3 and H4.

When environment is dynamic, it makes it compulsory for the organizations to look for new knowledge so that it can better align itself to the changing environment by modify and altering strategies. This will confirm H5 that in environment dynamism, potential absorptive capacity increase strategic flexibility (Hung & Chou,2013).

Future research should use qualitative or mixed methods to proof the results and also should use industry other than pharmaceutical as sample to generalize the results.

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