

DISCOURSE ON DYNAMIC CAPABILITITES OF PRIVATELY RUN HIGHER EDUCATION INSTITUTIONS IN LATVIA

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Abstract. There are no any indicators, showing that the Higher Education Institution's (HEI) market in Latvia can grow. The demographic decline, economic uncertainty and high unemployment rate allow predicting the exit from the market the weakest HEIs. The aim of the paper is to identify strategies that privately run HEI might pursuit in current high-velocity environment sustaining competitive advantages. Authors have applied the dynamic capabilities framework as a theoretical foundation and propounded four research questions. Having investigated the stage of Latvian privately run HEI industry consolidation, authors have answered the first research question: what should be the cornerstone of a HEI long term strategic plan in current industry consolidation stage? Then authors conducted the survey of students' opinions among different privately-run Latvian HEIs and answered second research question: what educational philosophies have been adopted by many privately run HEIs: customer or product oriented approach towards students? Next, the research paper identifies the necessity of product oriented approach and determined dynamic capabilities for such strategic move. Finally, authors answered on the forth research question: is it possible to develop and sustain the competitive advantage, developing international strategies by exploiting a HEI's resource and capabilities? Despite the limitations the paper has potential to generate a scholar's discussions and might lead to further research. Methodological, theoretical and practical implications are discussed.

Keywords: customer oriented approach, product oriented approach, VRIN resources, dynamic capabilities, international strategy.

Jel classification: I23, M10, M13.

1. Introduction

In contemporary European business environment, characterized by economic uncertainty, demographic decline and rapid technological changes, the marketplace requirements are a constantly moving target. Therefore, it is essential that European Higher Education Institution's (HEI) constantly update their curriculum and re-evaluate their pedagogical approaches (Emery *et al.* 2000). Latvian HEIs are not

the exclusion from this rule. The paper explores the new challenges and opportunities for the privately run HEIs in Latvia. There are no any indicators, showing that the HEIs market in Latvia can grow. The demographic decline, economic uncertainty and high unemployment rate allow predicting the exit from the market the weakest HEIs. The complex settings of Latvian HEIs shape the topicality of the research. The aim of the paper is to identify strategies that privately run HEI might pursue in current high-velocity environment sustaining competitive advantages. The research comprises two parts – the theoretical one, including the literature review, determining the theoretical frameworks of the research and defining the methodology of the investigation, and the practical part assuming the data collection and interpretation of results. In the process of investigation the cross-sectional and time-series data were used. The unit of analysis is privately run HEIs of Latvia. The state-run HEIs are not taken into consideration and only several notes are done on them, although the authors realize the difference between these institutions.

2. Literature review

Latvia successfully participates in the establishment of a European Higher Education arena and the majority of Bologna Process Reform is successfully implemented (Ministry Education and Science of Latvia 2012). Higher Education makes a three-fold contribution to a country's economic health. First it is beneficial for employment rates, second it is a key driver for long-term economic growth and third it appears to be beneficial for social cohesion. At present we, unfortunately, can conclude that the most of its goals were not achieved yet. The European countries have to improve the percentage of students enrolled in tertiary education and the educational quality of Europe's students. The reasons of the problems of HEIs in Latvia are similar and it's analyzed by many organizations and prominent researches (Foreign Investor Council 2012; Dombrovskis 2009). The outcomes of those researches are not very optimistic. Firstly, recent statistics from Eurostat, the EU's official statistics agency, have found that the Baltic States - particularly Latvia - are at the forefront of Europe's well documented demographic crisis. The report found that Latvia suffers both the lowest fertility rate in the EU and has the second lowest life expectancy, after Bulgaria (EU demography report 2010). Secondly, the intellectual brain drain has been going on in Latvia since about 2004, and then rising economic hardship forced many to search for better jobs abroad. Demographic problems are reflected on the number of students in Latvia that is constantly declining from maximum 131072 of HEIs' students in 2005/2006 academic year to minimum 84718 students in 2011/2012 (Latvian statistics 2012). Moreover, the World Bank estimates that by 2025, the number of students in HEIs will shrink more than primary and secondary schools, by a staggering 40 percent, due to emigration (Hanley 2011). Thirdly, the share of scientists aged 65 years old or more in universities was 25%, and in university research institutes 35%. Only 7 percent of scientists were under 36 years old (EU demography report, 2010). Finally, there is a

strong competition in the market for higher education among 35 higher education establishments, of which 18 HEIs are privately run (Dombrovskis 2009). It means that the demand will be shrunk whereas the supply side is already overinvested. HEIs need new business strategy and new educational approach to survive in new economic conditions. Investigation of published researches on the problems of Latvian HEI's industry has identified one unexplored important area of HEIs activity: what education philosophy towards students the HEIs employed so far: the product oriented and the customer oriented ones? Both approaches have their adherents. Many HEIs suppose the student is the customer of the HEI. If the students are supposed to be the customers, it means, they are "always right". The students are "buying" the program; they have the right and the responsibility to state what they want from the programs and how they think they should get it (Gordon 1996; Jones 1997). This maxim fully corresponds to the idea of obtaining the economic advantage in the short term: the students "customers" are satisfied, and the approach becomes as the profit-gaining approach. But any HEI is to weigh out the consequences of this approach. Some scholars researches seek to evaluate the arguments for and against the proposition that students in higher education are "customers" and should be treated as such (Eagle, Brennan 2007). 80% of all students prefer easy tasks, short and not demanding material and good marks (Gordon 1996; Jones 1997). Money goes after the student and lecturers wishing continue their employment show indulgence towards the students' ambitions (Gordon 1996; Jones 1997). The quality of education falls, and as a result, poor reputation decreases the rating of the HEI and the number of students. They want to have the diplomas of a prestige university! The vicious circle is closed! The "customer" concept into higher education degrades educational standards and damages educator/student relationships (Eagle, Brennan 2007). How the HEIs should turn the young people having no special knowledge and skills into well-educated, well-trained and well-qualified employee? The product-oriented approach allows achieving these aims. Notturmo wrote, that the product oriented approach in the HEI settings is "...the deliberate attempt to design a system whereby students begin as natural inputs and work their way through a program of study from which they emerge as more knowledgeable and capable individuals" (Notturmo 1997). Employer is a person or/and organization who is to evaluate the level of the HEIs from the outlook of potential to employ the graduates in the nearest future. Under such approach the students agree to keep to the program strictly because they believe, they will be prepared to face any challenge the real life gives them in the future. The rating, the reputation and the flow of the students will rise. However strategic shift from existing short term the customer oriented approach towards long term product oriented approach requires the contemporary strategic management of organizational resources and capabilities.

The exploration on how to manage organizational resources and capabilities to sustain competitive advantages remains the intrigues unit of research of strategic management science. Two major frameworks to identify the sources of competitive

advantages are: the resource based view (RBV) (Barney 1991) and dynamic capabilities view (DCV) (Teece *et al.* 1997) on competitive advantages have been successively developing since 1991 year. Barney defines that sustained competitive advantages must be found in the valuable, rare, imperfectly imitable, and non-substitutable, so called VRIN resources already controlled by a firm (Barney 1991). Barney called VRIN resources as “idiosyncratic firm attributes” of the firms’ competitive advantages. According to RBV the HEIs compete on the market managing three major heterogeneous idiosyncratic resources: academics possessing a *tacit knowledge*, often called “know-how” with individual tuition methods (Grant 2010) and providing scientific researches, the programs of HEI and HEI’s reputation. *Reputation, programs* and academic *personnel* of HEI are important *VRIN resources* so they are imperfectly immobile: path dependent, socially complex and casually ambiguous. What is more, the HEI has to realize the advantages of these VRIN resources and capabilities and takes to gain competitive advantages by operating in multiple markets simultaneously. International strategy simply refers to the concept of operating in multiple countries simultaneously (Barney 2012). The critiques of RBV argue that it seems to tell managers to obtain VRIN resources and develop appropriate competitive advantages of organization, but it is silent on how this should be done (Connor 2002; Miller 2003). Proponents of RBV recommend developing the RBV into a more viable theory of competitive advantage, especially if it is moved into a genuinely dynamic framework (Kraaijenbrink, Wijnhoven 2008). It is clear that in high-velocity environment HEI has to follow the changes very quickly and be dynamic in terms of strategic management of VRIN resources. Dynamic capability is defined by Teece as “the firm’s ability to integrate, build, and reconfigure internal and external resources to address rapidly changing environments” (Teece 1997). The first capability is creation of the strategic assets by the way of quick learning of both: organization itself and the employees. The second capability is integration of new strategic assets, created by the first capability, within the organization. The third capability is *transformation* of the existing assets. In case the HEI implements these capabilities for adjusting to the existing approach the HEI can dynamically change the strategy and sustain or at least create a series of temporary competitive advantages (Teece 2009).

3. Theoretical framework

The research investigates one *dependent variable*. The primary interest of the research is to identify strategies that privately run HEI’s might pursue to generate competitive advantages. Privately run HEI’s *competitive advantage* has become the dependent variable in our research. The following *independent variables* are supposed to be of primary significance for this investigation: *demographic decline and competition consolidation* stage of industry. *VRIN resources and dynamic capabilities* of HEIs are the moderating variables. The *moderating variable* is one that has a strong contingent effect on the independent variable-dependent variable relation-

ship (Sekaran, Bougie 2009). Educational *philosophies* (customer oriented approach or product oriented approach) and *international strategies* are two separate mediating variables. The *mediating variable* (or intervening variable) is one that surfaces between the time the independent variables start operating to influence the dependent variable and the time their impact is felt on it (Sekaran, Bougie 2009).

Four research questions to achieve the aim of the paper have been posted. *First research question* posed as follows: what is the consolidation stage of an industry of privately-run HEIs and what should be the cornerstone of a HEI's long term strategic plan? *Second research question* authors defined as follows: what educational philosophies have been adopted by most of HEIs in Latvia so far: the customer-oriented approach or the product-oriented approach? *Third research question* is what educational philosophy should be adopted by HEIs and what specific VRIN resources and dynamic capabilities will be needed to sustain competitive advantages? *Forth research question* defined as is it possible to develop and sustain the competitive advantage, employing international strategies by exploiting a privately run HEI's resource and capabilities?

4. Research design and methodology

Research comprises two types of data: cross-sectional data, describing the situation for the previous academic year 2011/2012 and time series data contains data for the academic years starting from 1991/1992 till 2011/2012 academic years. The survey was conducted among the students of different universities during two weeks and 52 students took part in this poll. Sample sizes larger than 30 and less than 500 are appropriate for most business research (Sekaran, Bougie 2009). The group of students for polling was randomly selected. The questionnaires site was open for fortnight. The students were asked to visit the site and answer the questions. The students were asked to evaluate every of 28 statements according to the 10 points interval scale from "strongly disagree" to "strongly agree". The questions were logically divided into three sets for the purposes of research. First set of questions was designed to identify how the students of HEIs perceive themselves- as the customer or as the product of HEIs, the second set was designed to define how students perceive the knowledge and competences delivered by the HEIs, and the last one was designed to find out what is the real motivation for them to receive the HE diploma. The received data has been possessed and interpreted by the researchers below.

5. Data analysis and interpretation

To answer *first research question*, authors have applied the Consolidation curve theory developed by Deans, Kroeger and Ziecel (Deans *et al.* 2001). Dean and colleagues has identified that industry move through four stage of consolidation: Opening, Scale, Focus and, finally, Balance and Alliance. They predicted that an industry will take on average 22–25 years to progress through all four stages and in

the future they expected it to be even quicker. Every company in every industry will go through four stages or disappear. Thus, the understanding of where in the cycle an industry is should be the cornerstone of a company's long term strategic plan. The privately run HEIs Latvian market is represented by 18 privately run HEIs with 22 634 students in 2011/2012 academic year. Higher School of Business TURIBA controls 23% of the market, International Baltic Academy has got 17% and Transports and Communication Institute has reached 13%. CR3 ratio is the combined market share of the three largest companies in an industry. Thus, the CR3 ratio of HEIs equals 52% in 2011/2012 academic year (Latvian statistics 2012). That means HEIs industry is moving through third stage called Focus. Company in Focus stage industries need to emphasize their *core (dynamic) capabilities*, focus on profitability, and either shore up *or part with weak business and attacking profitable niches* (Deans *et al.* 2001). Because the most privately run HEIs started up in 1991-1992 and taking into consideration average 25 years progress through all four stage, we might predict the industry HEI will go to stage 4 "Balance and Alliance" (Deans *et al.* 2001) in the nearest future. Company must be alert to the potential for industry regulation and the danger of being lulled complacency by their own dominance. Thus, we have answered on the first research question. Having answered *second research question* we have carried out a survey of students' opinion among different HEIs. The most spectacular results are as follows: 90% of the students recognized the HEI programs are to fully correspond with the practical demands of the market. 80% of the students answered that they are a customer of the HEI service and only 20% that they are a product of the HEI. Students who view themselves as customers are likely to hold attitudes and to engage in behaviors that are not conducive to success (Finney 2010). Almost 88% said they have possibility to evaluate the knowledge and competences of the tutors, but only 40% of the students say they are to trust in the tutors' competences and knowledge. For solving the conflict 70% of students answered it is admissible to attract the HEI authorities. It is clear the tutors will try to avoid the situation when the authorities are involved in conflict. It means, the tutor will try to solve the problem himself, and she/he will not stand against the students' trend. Even more serious is the fact that the students have possibility to evaluate the lecturers. From one hand it is logical, that the HEI's management wants to know the degree of students' satisfaction with the lectures' work. From the other hand, the most demanding tutors are at risk to receive low marks, as far as students do not like lecturers who put them low marks or demand serious assignments. Then, 85% of the students said that knowledge is important for the career but chance, opportunity and VIP protections have got higher importance. Only 45% of the students answered that the theoretical knowledge adopted at the HEI are applicable in practice. 75% of the students said that the HEI's reputation has a primary importance for choosing the HEI to study at. Finally, 68% of the students answered that it is not interesting to study at the HEI but the graduation and diploma of the prestige HEI can bring additional advantage to their career. It became clear that the majority of stu-

dents do not highly appreciate the higher education and diploma of HEI per se, but as supportive one in their career. Answer on the second research question became obvious: HEIs adopt the customer-oriented educational philosophy with minor elements of the product-oriented approach. The *third research question* was what educational philosophy should be adopted by privately-run HEIs and what specific VRIN resources and the set of dynamic capabilities will be needed to sustain or create a series of temporary competitive advantages? Survey identified the following capabilities and resources are needed to sustained competitive advantages for the customer-oriented approach: knowledgeable and good educated lecturers, ability to give professional knowledge with fun and without great efforts from the students' side; relatively low level of requirements; the abilities to combine delivering lectures and own researches outcomes, to disseminate research results on the international scientific conferences and publish proceedings in good rating scholar journals and therefore facilitate to increase the rating and reputation of HEI that are in demand among the potential students. If the HEI practices the customer-oriented approach, the end products are diplomas itself for above mentioned 80% of the students and knowledge and competences for the best 20% of the students. The product oriented approach doesn't deny the VRIN resources needed for customer oriented approach but plus lay stress on new set of dynamic capabilities: to conduct cutting edge researches and to publish in high quality international scholarly journals; employ the up-to-date technologies and the modern methods of the training and be able to prepare students to solve the challenging and demanding innovative tasks corresponding to the modern business life requirements and workplaces. If HEI employs product oriented strategy, the end products are 80% of graduates with the outstanding capability to exploit received knowledge and skills, their creativity and innovativeness to solve contemporary issues of present and future employers whereas for the last 20% of graduates a product is a very prestige diploma itself. In demographic decline and highly consolidated competition on the marketplace this approach seems the best prospective to HEIs to survive and to compete successively. The HEIs should be able to make strategic shift and quickly reorganize its VRIN resources as well as to transform them and renew the competitive advantage they had. That means that HEIs need dynamic capabilities. The primary dynamic capabilities of HEIs are *to sense* the necessity of changes of strategy and involve scanning and research of what the employers (customers) needs (Teece 2007). The employers of the companies who use knowledge and skills of the graduates are the customers in the product oriented approach. The dynamic capabilities determine, what technologies to attract for creating the new knowledge and skills for meeting the changing demands of the customers employers, what features new products should comprise, they observe the HEIs structure of cost structure and profit formula and decide how to "redesign" the business model satisfy the market segment which is in need of new products (graduates) and define, how to deliver this products. Practically, the dynamic capabilities are the organizational procedures such as generation of the new products, signing new partnerships, creating the new busi-

ness models contributory to creating the additional value for the HEIs by the way of manipulating the existing idiosyncratic resources: HEIs academic personnel, program and reputation. The time lag between the real changes on the market and *sensing and seizing* by the HEIs is at least 2-3 years, as the HEI has not only *to sense* the future market changes and *to seize* the opportunity to change, but also renew the threshold resources like licenses and accreditations certificates. This great time lag differ the HEIs from other companies operating on the market. It gives the special importance *to sensing* and predicting of opportunities that becomes of primary important dynamic capabilities for the HEIs who wants to survive and develop. Thus, the important task for the HEIs today is switching from the student-customer to the student-product approach. To begin with the forecast of the future market needs and reorganized the existing HEI's resources. HEI is to decide what VRIN resources are to be transformed to face the new demands, what VRIN resources or organizational assets are to be taken as the new ones and getting rid of resources unable to add value any more. It concerns the curriculum, programs and syllabi first of all. Changes in programs and syllabi can result in necessity to change the equipment, technologies and other tangible assets. When the process of changing the programs, syllabi and infrastructure has finished the HEI faces the problem of supplying the new syllabi with corresponding tutors. When the syllabi and tutors are ready, the process of the students' competitive selection starts. In case the programs are ready and tutors know what level of knowledge and what specific skills and competences they want to see in their students, the competition among students itself becomes clear. If it is a really competitive selection, the potential students should have the incentive to enter this HEI. Next step of this HEI is to develop competitive advantages on the international scale. Last but not least, the stage is employment assistance. It can be the most problematic for Latvia nowadays, but it is clear, it is the absolutely necessary condition for the long term success. Taking in consideration of average unemployment rate in Europe and particularly in Latvia this stage seems absolute utopia for many small privately run HEIs.

The best example of product oriented approach toward students as well as successful international strategy development to sustain competitive advantage is privately runs Stockholm Economic School, having its branch in Riga. The Stockholm School of Economics operates in such countries as Japan, Latvia, Russia and Finland. Latvian branch is Riga High Economic School (School) been started functioning in 1994. The high level of service provided is proven by accreditation with the European Quality Improvement System (EQUIS), which shows that this school meets the most rigorous international criteria. The school cooperates with the best business schools all over the world like London School of Economics and HEC Paris; it also cooperates with a great number of multinational corporations. This fact makes the product of this school (graduates) highly prestigious, the diploma of this school makes the employment in the best world corporations possible, and potential students are ready to choose it among the others. The School presents the programs and syllabi that are the same in all the countries, but they use absolutely

different strategies for sweeping the market. The school sets itself as an elite school with very high fees in Russia and in Japan. In Finland, where the education is generally financed by state, the service is practically free of charge for the most categories of students. In Latvia the School implemented hybrid strategy – they started with free admission, but with very rigorous selection of students, thus it created the reputation of really strong and prestigious business school with no sentiments, and to graduate from this school the student should be the best as the product. Then when the position became strong enough and the school gained its reputation in the Baltic countries, they started charging the service with high fees as well. At first the School employed only the tutors from the head university, and only after several years of operating on the market they start employing the lecturers from the Baltic countries. Certainly, it is possible only in case the HEI has a robust financial support and has ambitions not only to survive but to thrive first of all.

Would Latvian privately run HEI with customer oriented approach be able to develop and sustain the competitive advantage, pursuing international strategies by exploiting an existing HEI's resource and capabilities? This *forth research question* will be answered by using resources based view (RBV) on competitive advantages. Having jointed to the European Union, Latvian HEIs have become a part of the European HEIs. The new status, meaning nothing for our European counterparts, opens new possibilities in the Eastern side. How privately run HEIS can to attract international students? There can be several scenarios – inviting them in Latvia, entering the educational market of target countries and hybrid strategies. All of them have their own pros and cons. Inviting students to Latvia brings a benefits to the country – export increase, but the scale is not impressive so far. Entering the market of one of the eastern countries can bring the scale, the great amount of students, but the difficulties are more serious than in the first case. Exporting the HEI to other countries, the HEI faces the issue of employing the new academic staff. The easiest one is employing the local tutors. It has certain advantages – people live in the region, they integrated into local society. Moreover, they know the cultural context of the region, the stereotypes the students have and they are psychologically ready for working in this European branch of the Latvian HEI. The problem is connected with the above discussed VRIN resources: *programs, tacit knowledge of tutors and reputation of HEI* as the sources of sustained competitive advantages. Tacit knowledge of the personnel of Latvian HEI put forward the comparative advantage, and it can be prolonged and sustainable. However, the local *tutors* have no possibility to adopt the tacit knowledge of Latvian HEI, and it is an insolvable issue. It is quite possible their qualification is high, even sometimes higher than their colleagues in Riga have, but in any case the implicit competences of the Latvian HEI will be lost, and it might become crucial. Another VRIN resource is *Latvian HEI reputation*. The absolutely natural idea of local students is the following: why should we go to the Latvian HEI, if the same local tutors work there? Local students can enter the local HEI and receive the knowledge from same tutors but for little money. Certainly, the diploma will be of European, but it is the

only difference! Under these circumstances it is obvious the competitive advantages will not be sustainable.

The best exit from this situation is seemed to be in employing tutors from the Latvian HEI, they can support the tacit knowledge existing in the head HEI and the *reputation* of the HEI does not collapse. Here, the problem is of cultural nature. These countries are significantly different from the European ones in cultural dimension (Hofstede 2001; Blodgett *et al.* 2006). The culture distance seems to be important; it is not easy to sustain advantages if you do not understand the cultural context of the country. Since the work with the students always involves interpersonal component, it might become crucial for the successful teaching processes. This choice might have the problems, existing in the previous case: lack of belief from the local students' part, lack of exploiting tacit knowledge of head HEI's personnel and possibility to loss of reputation. The third type of the problem solution is the *hybrid* strategy. It means the tutors from the head HEI work in the new branch together with the local lecturers. The local lecturers open the mental, cultural and national peculiarities of the local students, and this allows conducting the teaching process much easily and successfully. At the same time the lecturers from the head HEI share their experience and the tacit knowledge existing in the home HEI. The branches are supported through the scientific scholars' projects, guest lecturers and seminars for local tutors, students and lecturers exchanges. This approach is supposed to be the most pragmatic. With the certain time lag this will result in opportunities to employ only the local tutors. Having answered fourth research question, privately run Stockholm School of Economics should be mentioned a convincing example of successful international strategy in Latvia.

6. Conclusion

Excellence in higher education is of paramount importance in an increasingly global and competitive economy. The higher education system of Latvia is in need of strategic shift if it is to become internationally competitive, prevent 'human capital flight' and turn into a key driver of Latvia's economic development (Foreign Investor Council 2012). On the organizational level HEIs need new business strategy and the shift of current education philosophy. Latvian HEIs possessed the heterogeneous idiosyncratic VRIN resources to sustain position in the market in past decade. But now the situation has been dramatically changed. The dynamic capabilities of *sensing and seizing* new external environment as well as *transforming* of VRIN resources have become strategically important for HEIs. New education philosophy comprises the competitive selection of students, selection of new lecturers, assistance in the graduates' employment and the feedback from them and their employers, in other words, execute the product-oriented approach. What is more, the privately run HEI would be able to develop successful international strategy. This strategic shift might permit to increase the quality of education, to concentrate financial resources on creation the up-scale HEIs and to provide the real opportuni-

ties of the human capital development in Latvia and contribute country's economic health. Regarding the limitations, it also seems to be important to attract the tutors to the survey, as their opinion is much more reliable in this respect. We hope the idea presented in the paper has potential to generate a lot of scholars' discussions and needs to be further researched extending geographical area of research.

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