



Financial Optionality as a Strategic Response to Environmental Volatility: A Conceptual Theory of Resource Flexibility and Organizational Growth

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Article History:

Submitted: 28-03-2026

Approved: 19-06-2026

Published: 13-07-2026

Available at the open access
journal:<https://sciedex.com/innogest>

Innogest - Journal of Corporate and
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Abstract

Organizations increasingly operate in environments characterized by persistent environmental volatility, requiring financial resources to serve not only as buffers against uncertainty but also as strategic enablers of organizational adaptation. Although prior studies have extensively examined financial flexibility and strategic adaptability, existing research remains fragmented in explaining how financial capacity is transformed into adaptive organizational capabilities that sustain long-term growth. This conceptual paper addresses this theoretical gap by developing a middle-range theory that introduces financial optionality as a higher-order organizational capability linking financial flexibility, resource flexibility, and organizational growth. Drawing on the integration of Real Options Theory, Financial Flexibility, Dynamic Capabilities, Strategic Flexibility, and Resource Orchestration, the study develops an integrative conceptual framework and a set of theoretically grounded propositions explaining the sequential mechanism through which organizations create, preserve, and selectively exercise financial choices under environmental uncertainty. The proposed theory extends existing literature by distinguishing financial optionality from financial flexibility and positioning it as the missing explanatory mechanism connecting financial capacity with strategic adaptation. The framework provides a foundation for future empirical validation while advancing interdisciplinary dialogue between corporate finance and strategic management in understanding organizational adaptation under persistent environmental volatility.

Keywords

financial optionality; financial flexibility; environmental volatility; resource flexibility; dynamic capabilities; organizational growth

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1. Introduction

Organizations increasingly operate in environments characterized by persistent volatility rather than temporary disruption. Rapid technological change, geopolitical tensions, financial market instability, supply-chain disruptions, and recurrent global crises have fundamentally altered the conditions under which strategic decisions are made. Environmental volatility not only increases uncertainty regarding future demand and competitive dynamics but also complicates firms' ability to allocate financial resources efficiently while preserving long-term growth opportunities. Classical studies distinguish environmental uncertainty into state, effect, and response uncertainty, emphasizing that organizations frequently struggle not only to predict environmental change but also to determine its strategic implications and appropriate responses (Milliken, 1987). Likewise, environmental dynamism and complexity continuously reshape firms' strategic contexts, making organizational adaptation an ongoing rather than episodic challenge (Dess & Beard, 1984; Wernerfelt & Karnani, 1987).

Recent crises have reinforced the strategic importance of financial preparedness under extreme uncertainty. During the COVID-19 pandemic, firms experienced abrupt revenue declines, severe financing constraints, and heightened capital market uncertainty, exposing substantial differences in organizational resilience. Evidence suggests that firms possessing greater financial flexibility were more capable of maintaining operations, preserving investment capacity, and responding proactively to emerging opportunities despite deteriorating external conditions (De Vito & Gómez, 2020; Ding et al., 2021; Fahlenbrach et al., 2021). Similarly, precautionary financing behavior, increased cash accumulation, and improved access to debt markets became central strategic responses to uncertainty rather than merely conservative financial policies (Acharya & Steffen, 2020; Favara et al., 2021; Hassan et al., 2023). These developments indicate that financial resources increasingly serve strategic purposes beyond short-term liquidity management.

Existing research has extensively examined financial flexibility as a firm's ability to preserve financing capacity through cash holdings, unused debt capacity, liquidity reserves, and prudent capital structure management (Denis, 2011; Gamba & Triantis, 2008). Financial flexibility has consistently been associated with enhanced investment capability, firm value, and resilience during periods of financial distress (Arslan-Ayaydin et al., 2014; Marchica & Mura, 2010). Corporate finance scholarship therefore largely conceptualizes financial flexibility as the availability of financial resources that enable firms to absorb shocks and continue investing under financing frictions (Almeida et al., 2004; Denis & Sibilkov, 2010; Opler, 1999). While this perspective has substantially advanced understanding of corporate liquidity management, it predominantly treats financial resources as stocks of available capital rather than as strategic mechanisms for creating future opportunities.

Parallel developments in strategic management offer a complementary but largely disconnected perspective. Real options theory argues that uncertainty can generate value by encouraging organizations to maintain strategic options before making irreversible commitments (Bowman & Hurry, 1993; McGrath, 1997; Trigeorgis & Reuer, 2017). Rather than minimizing uncertainty, firms may deliberately preserve flexibility to defer, expand, contract, or abandon investments as new information emerges (Kogut & Kulatilaka, 1994; Kulatilaka & Perotti, 1998). Similarly, strategic flexibility and dynamic capabilities literature emphasizes that competitive advantage increasingly depends on organizations' abilities to sense environmental change, reconfigure resources, and orchestrate capabilities in response to evolving market conditions (Eisenhardt & Martin, 2000; Sirmon et al., 2007a, 2011; Teece et al., 1997). Although these streams recognize flexibility as a strategic capability, they provide limited explanation of how financial capacity itself becomes an organizational mechanism that enables continuous resource reconfiguration and sustained growth.

Consequently, an important conceptual disconnect remains between corporate finance and strategic management. Finance literature predominantly explains what financial flexibility is and why it contributes to firm value, whereas strategic management literature explains how organizations adapt through strategic options and resource orchestration. The mechanism linking financial capacity with strategic adaptation remains insufficiently theorized. Existing studies generally conceptualize cash holdings, debt capacity, and liquidity as passive financial reserves, while strategic flexibility research frequently assumes the existence of deployable resources without explicitly explaining how financial structures generate or preserve those strategic choices (Brozovic, 2018; Trigeorgis & Reuer, 2017). As highlighted in the reference framework, financial flexibility has largely been treated as a condition of available financial capacity rather than as an organizational capability for creating, maintaining, and selectively exercising financial choices under uncertainty.

This conceptual limitation suggests the need for a broader theoretical perspective that extends beyond traditional notions of financial flexibility. We propose financial optionality as a higher-order organizational capability that enables firms to deliberately create, preserve, and execute multiple financing, investment, and resource-allocation options before environmental uncertainty is resolved. Unlike financial flexibility, which primarily reflects the availability of financial resources, financial optionality emphasizes the organizational capability to transform financial capacity into strategic choices that can be activated selectively as environmental conditions evolve. This perspective integrates insights from real options theory, strategic flexibility, dynamic capabilities, and resource orchestration into a unified explanatory mechanism capable of linking financial resources with organizational adaptation and growth.

Accordingly, this conceptual paper develops a middle-range theory explaining how financial optionality functions as a strategic response to environmental volatility through resource flexibility. The proposed theory argues that financial optionality enables organizations not merely to survive periods of uncertainty but also to reconfigure resources, capture emerging opportunities, and sustain organizational growth under volatile conditions. By integrating previously fragmented theoretical perspectives, this study contributes to corporate finance and strategic management literature through three primary contributions. First, it reconceptualizes financial flexibility as an antecedent of financial optionality rather than an endpoint of financial policy. Second, it identifies resource flexibility as the central explanatory mechanism connecting financial optionality with organizational growth. Third, it develops an integrative middle-range theory that clarifies when, how, and under what boundary conditions financial optionality generates superior strategic outcomes in environments characterized by persistent volatility.

2. Theoretical Foundations and Domain Specification

2.1 Real Options Theory: From Investment Decisions to Strategic Choice

Real Options Theory (ROT) provides the primary theoretical foundation for understanding how organizations create value under uncertainty. Unlike traditional investment models that emphasize immediate commitment based on expected net present value, ROT argues that uncertainty itself may create strategic value by allowing firms to delay, expand, contract, stage, or abandon investments as new information emerges (Bowman & Hurry, 1993; McGrath, 1997). In this perspective, organizations maximize value not merely by selecting optimal investments but by preserving future strategic choices before uncertainty is resolved.

Subsequent developments extended ROT beyond capital budgeting toward strategic management. Kogut & Kulatilaka (1994, 2001) demonstrated that organizational capabilities and multinational networks can themselves function as real options because they provide firms with multiple paths for strategic adaptation. Similarly, Kulatilaka & Perotti (1998) argued

that firms deliberately maintain growth options to capture future opportunities, while Trigeorgis & Reuer (2017) synthesized two decades of research by positioning real options as an overarching framework for strategic decision-making under uncertainty. However, scholars also acknowledge important conceptual boundaries. Adner & Levinthal (2004) caution against treating every flexible investment as a real option, emphasizing that option value requires identifiable future decision rights under uncertainty rather than merely adaptive behavior. Consequently, although ROT explains why preserving future choices creates value, it pays relatively limited attention to the organizational and financial conditions that enable firms to maintain such choices over time.

2.2 Financial Flexibility as the Foundation of Financial Capacity

Corporate finance literature approaches uncertainty from a different perspective by emphasizing the importance of financial flexibility. Financial flexibility generally refers to a firm's ability to obtain and deploy financial resources at relatively low cost when attractive investment opportunities or unexpected shocks arise (Denis, 2011; Gamba & Triantis, 2008). This flexibility is reflected through cash holdings, spare debt capacity, liquidity reserves, and financing policies that preserve future borrowing capacity (Almeida et al., 2004b; Marchica & Mura, 2010; Opler, 1999).

Empirical research consistently demonstrates that financially flexible firms invest more effectively during periods of financial constraint and experience superior resilience during economic crises (Arslan-Ayaydin et al., 2014; Fahlenbrach et al., 2021; Rapp et al., 2014). Financial flexibility therefore represents an important strategic asset because it reduces dependence on costly external financing and enhances managerial discretion when environmental conditions deteriorate (Denis & Sibilkov, 2010; Favara et al., 2021)

Despite these contributions, existing studies predominantly conceptualize financial flexibility as a financial condition rather than an organizational capability. Financial resources are commonly viewed as available reserves that buffer uncertainty, whereas relatively little attention is devoted to explaining how those resources generate multiple strategic alternatives that can be selectively exercised over time. As a result, the literature largely explains the availability of financial capacity but provides limited theoretical insight into how such capacity becomes an engine of strategic adaptation.

2.3 Strategic Flexibility and Dynamic Capabilities

Strategic management research offers complementary explanations regarding organizational adaptation. Strategic flexibility refers to a firm's ability to respond effectively to changing environmental conditions through timely strategic adjustment and resource redeployment (Sanchez, 1995; Volberda, 1996). Organizations possessing greater strategic flexibility are generally better positioned to respond to technological change, competitive turbulence, and economic crises because they maintain broader strategic options than less flexible competitors (Brozovic, 2018; Grewal & Tansuhaj, 2001).

The dynamic capabilities perspective extends this argument by emphasizing higher-order organizational capabilities that enable firms to sense environmental change, seize emerging opportunities, and continuously reconfigure organizational resources (Eisenhardt & Martin, 2000; Teece, 2007; Teece et al., 1997). Resource orchestration further explains that competitive advantage depends not only on possessing valuable resources but also on effectively structuring, bundling, and leveraging them to create value (Sirmon et al., 2007, 2011).

Although these perspectives substantially improve understanding of organizational adaptation, they generally assume that deployable resources already exist. Financial resources are rarely treated as a central mechanism explaining how organizations preserve multiple strategic pathways before reconfiguration occurs. Consequently, dynamic

capabilities literature explains resource transformation but only partially addresses how firms create and maintain the financial discretion required to support continuous adaptation under persistent uncertainty.

2.4 Comparative Analysis and Theory Integration Opportunities

The four theoretical perspectives reviewed above explain different dimensions of organizational adaptation under uncertainty, yet none independently provides a comprehensive explanation of financial optionality. Real Options Theory explains the value of preserving future strategic choices but focuses primarily on investment decisions. Financial flexibility explains how firms preserve financing capacity but largely treats financial resources as static reserves. Strategic flexibility emphasizes adaptive strategic behavior, whereas dynamic capabilities explain organizational resource reconfiguration through higher-order capabilities.

The theoretical perspectives reviewed above offer complementary insights into organizational adaptation under uncertainty, yet they differ substantially in explaining the strategic role of financial resources and flexibility.

Table 1. Comparison of Existing Perspectives on Financial Flexibility and Financial Optionality

Perspective	Primary Explanation	Limitation	Relevance to Proposed Theory
Real Options Theory	Explains how preserving future investment choices creates strategic value under uncertainty.	Focuses primarily on investment decisions rather than organizational financial capabilities.	Provides the logic of option preservation underpinning financial optionality.
Financial Flexibility	Explains how liquidity and financing capacity improve resilience and investment capability.	Treats financial resources mainly as available capacity rather than strategic choices.	Serves as the financial foundation from which financial optionality develops.
Strategic Flexibility & Dynamic Capabilities	Explain how organizations adapt through resource reconfiguration and capability renewal.	Largely assume financial resources already exist without explaining their strategic creation.	Provide the adaptive mechanism activated through financial optionality.
Financial Optionality (Proposed)	Explains how firms intentionally create, preserve, and selectively exercise financial choices to support strategic adaptation.	Integrates previously fragmented perspectives.	Bridges corporate finance and strategic management through a unified explanatory mechanism.

Source: Developed by the author based on Bowman and Hurry (1993), Gamba and Triantis (2008), Denis (2011), Teece et al. (1997), Sirmon et al. (2007), Brozovic (2018), and the conceptual synthesis developed in this study.

Table 1 demonstrates that existing theories illuminate different aspects of organizational adaptation but remain theoretically fragmented. Real Options Theory emphasizes strategic choices, Financial Flexibility focuses on financing capacity, and Strategic Flexibility and Dynamic Capabilities explain resource adaptation. However, none explicitly theorizes how financial capacity is transformed into executable strategic choices, thereby motivating the introduction of financial optionality as an integrative organizational capability.

The comparison indicates an unresolved theoretical gap at the intersection of finance and strategy. Existing theories explain either the creation of strategic options or the preservation of financial resources, but they rarely integrate both into a unified mechanism explaining how organizations intentionally create, preserve, and selectively activate financial choices to support long-term growth. This fragmentation limits current understanding of why firms

possessing similar levels of financial flexibility often exhibit markedly different adaptive capabilities during periods of environmental volatility.

Accordingly, this study proposes that financial optionality should be conceptualized as an integrative construct that bridges these theoretical perspectives. Rather than replacing financial flexibility or dynamic capabilities, financial optionality builds upon them by explaining how financial capacity is transformed into a portfolio of executable strategic choices that facilitate resource flexibility and organizational growth.

2.5 Domain Specification

The proposed theory focuses on the organizational level of analysis, where strategic financial decisions interact with resource allocation processes under conditions of persistent environmental volatility. The central phenomenon is not the accumulation of financial resources itself but the organizational capability to deliberately preserve, generate, and selectively execute financing, investment, and resource-reallocation options as uncertainty unfolds. This conceptualization follows the distinction articulated in the reference framework between financial flexibility, which represents the availability of financial capacity, and financial optionality, which represents the capability to transform that capacity into strategic choices supporting organizational adaptation and growth.

The explanatory scope of the proposed theory is therefore bounded to organizations operating in environments characterized by elevated uncertainty, financing frictions, and continuous strategic change. The theory is expected to have greater explanatory power in industries where investment commitments are difficult to reverse, external financing conditions fluctuate substantially, and competitive advantage depends on rapid resource reconfiguration. By integrating insights from corporate finance and strategic management, the proposed domain positions financial optionality as the missing theoretical mechanism linking financial capacity, resource flexibility, and sustainable organizational growth under environmental volatility.

3. Financial Optionality as Strategic Resource Flexibility

3.1 Defining Financial Optionality

Although financial flexibility has become an established concept within corporate finance, its predominant interpretation emphasizes the availability of financial capacity rather than the strategic capability to exploit that capacity under uncertainty. Existing studies generally define financial flexibility through cash reserves, unused debt capacity, liquidity, and financing accessibility, all of which enable firms to withstand financial shocks and preserve investment capability (Denis, 2011; Gamba & Triantis, 2008; Rapp et al., 2014). While these resources undoubtedly constitute important organizational assets, they do not inherently explain why firms possessing comparable financial capacity often exhibit substantially different adaptive performance during periods of environmental turbulence.

Building on the theoretical synthesis developed in the previous section, this paper conceptualizes financial optionality as a higher-order organizational capability to intentionally create, preserve, and selectively execute multiple financing, investment, and resource-allocation choices before environmental uncertainty is resolved. This definition extends the logic of real options theory beyond investment timing by incorporating organizational capabilities that continuously maintain alternative financial pathways. Rather than treating financial resources as static reserves, financial optionality views them as strategic enablers that generate future decision rights, allowing managers to postpone irreversible commitments while retaining the capacity to respond quickly when new information emerges (Bowman & Hurry, 1993; McGrath, 1997; Trigeorgis & Reuer, 2017).

Consequently, financial flexibility becomes a necessary but insufficient condition for financial optionality. Financial flexibility reflects the availability of financial resources, whereas financial optionality represents the organizational capability to transform those resources into executable strategic alternatives. This distinction follows the conceptual positioning proposed in the reference framework, which identifies financial optionality as the capability to maintain and activate financial choices rather than merely accumulate financial capacity.

The proposed theory relies on conceptually distinct yet interrelated constructs whose precise definitions establish the theoretical boundaries and explanatory logic underlying financial optionality and organizational adaptation.

Table 2. Definitions of Core Constructs

Construct	Conceptual Definition	Theoretical Foundation
Environmental Volatility	Persistent and unpredictable changes in technological, competitive, financial, and institutional conditions that increase strategic uncertainty and complicate organizational decision-making.	Milliken (1987); Dess and Beard (1984)
Financial Flexibility	The availability of financial capacity through liquidity, cash holdings, borrowing capability, and financing access that enables firms to respond to unexpected events and investment opportunities.	Gamba and Triantis (2008); Denis (2011)
Financial Optionality	A higher-order organizational capability to create, preserve, and selectively exercise multiple financing, investment, and resource-allocation choices before uncertainty is resolved.	Proposed in this study, integrating Real Options Theory and Dynamic Capabilities
Resource Flexibility	The organizational capability to redeploy, reconfigure, and recombine strategic resources efficiently in response to changing environmental conditions.	Sanchez (1995); Sirmon et al. (2007)
Organizational Growth	Sustainable organizational expansion achieved through effective strategic adaptation, opportunity exploitation, and continuous value creation under uncertainty.	Conceptual synthesis developed in this study

Source: Developed by the author based on Milliken (1987), Dess and Beard (1984), Gamba and Triantis (2008), Denis (2011), Sanchez (1995), Sirmon et al. (2007), and the conceptual synthesis presented in this study.

Table 2 clarifies the conceptual boundaries of the proposed theory by distinguishing financial resources, organizational capabilities, and strategic outcomes. In particular, it highlights financial optionality as a capability rather than a financial condition, thereby differentiating it from financial flexibility and establishing its central role in explaining how organizations transform financial capacity into adaptive resource deployment and sustained growth.

3.2 Financial Optionality as the Mechanism of Resource Flexibility

The central proposition of this paper is that financial optionality functions as the missing mechanism connecting financial resources with strategic adaptation. Existing finance literature explains why firms preserve financial capacity, whereas strategic management literature explains how organizations reconfigure resources. However, neither stream adequately explains how financial resources are transformed into adaptive organizational behavior.

Financial optionality addresses this gap by enabling managers to maintain a portfolio of executable strategic choices. These choices may include delaying investments until uncertainty decreases, accelerating expansion when opportunities emerge, restructuring financing arrangements, reallocating capital across business units, or acquiring strategic

assets during periods of market disruption. Such actions illustrate that the value of financial resources lies not only in their availability but also in their capacity to preserve future strategic discretion.

This mechanism closely aligns with real options theory, where value arises from maintaining future decision rights (Kogut & Kulatilaka, 1994; Kulatilaka & Perotti, 1998), while simultaneously incorporating the resource orchestration perspective, which emphasizes continuous structuring, bundling, and leveraging of organizational resources (Sirmon et al., 2007b, 2011). Financial optionality therefore serves as the bridge between financial capacity and resource orchestration by ensuring that organizations possess both the means and the discretion to adapt as environmental conditions evolve.

Accordingly, resource flexibility should not be interpreted merely as operational adaptability but as the organizational outcome of successfully exercising financial options. Firms possessing stronger financial optionality are expected to reallocate resources more efficiently, avoid premature commitment, and capture emerging opportunities faster than competitors constrained by rigid financial structures.

3.3 Developing the Causal Mechanism

The proposed theory explains organizational adaptation through a sequential causal mechanism consisting of five interconnected stages.

First, environmental volatility increases uncertainty surrounding future market conditions, financing availability, technological trajectories, and competitive dynamics (Dess & Beard, 1984; Milliken, 1987). Under such circumstances, immediate commitment to irreversible investments becomes increasingly risky.

Second, organizations possessing stronger financial flexibility retain greater financing capacity through liquidity, borrowing ability, and conservative financial policies (Denis, 2011; Gamba & Triantis, 2008). However, financial capacity alone does not automatically generate adaptive advantage.

Third, firms exhibiting financial optionality actively transform available financial resources into multiple executable strategic alternatives. Rather than committing resources immediately, managers intentionally preserve alternative financing and investment pathways until uncertainty declines. This capability expands managerial discretion while reducing the opportunity cost of irreversible decisions.

Fourth, these preserved options facilitate greater resource flexibility, enabling organizations to reconfigure assets, redirect investment priorities, restructure resource portfolios, and mobilize strategic capabilities in response to changing environmental signals. This process reflects the continuous orchestration of organizational resources emphasized within dynamic capability theory (Helfat & Martin, 2015; Teece, 2007).

Finally, enhanced resource flexibility improves organizational growth by allowing firms to exploit emerging opportunities while minimizing losses associated with strategic rigidity. Growth therefore becomes an outcome of adaptive resource deployment rather than merely financial abundance. This mechanism integrates corporate finance with strategic management by explaining how financial capacity evolves into organizational adaptation and ultimately supports sustainable growth.

3.4 Boundary Conditions

The proposed mechanism is unlikely to operate uniformly across all organizational contexts. Several boundary conditions influence the effectiveness of financial optionality.

First, the theory is expected to exhibit greater explanatory power under high environmental volatility, where uncertainty increases the value of preserving future strategic choices

(Hassan et al., 2023; Trigeorgis & Reuer, 2017). Under relatively stable conditions, the benefits of maintaining multiple financial options may decline because future outcomes become more predictable.

Second, financing frictions moderate the value of financial optionality. When external capital becomes expensive or difficult to obtain, organizations possessing stronger optionality are better positioned to sustain strategic investments using internally preserved financial capacity (Campello et al., 2010; Fazzari et al., 1988).

Third, managerial capability influences the realization of financial optionality. Preserving strategic options creates value only when managers correctly interpret environmental signals and execute appropriate financial choices. This assumption is consistent with the microfoundations of dynamic capabilities emphasizing managerial cognition and decision-making (Helfat & Peteraf, 2015).

3.5. Proposition Development

The proposed theoretical logic generates five interrelated propositions.

Proposition 1.

Higher environmental volatility increases the strategic value of financial optionality because uncertainty amplifies the benefits of preserving executable financial choices.

Proposition 2.

Financial flexibility positively influences financial optionality by providing the financial capacity required to create and maintain alternative financing and investment options.

Proposition 3.

Financial optionality positively enhances resource flexibility by expanding managerial discretion to reconfigure organizational resources as environmental conditions evolve.

Proposition 4.

Resource flexibility positively contributes to organizational growth by enabling timely resource reallocation, opportunity exploitation, and strategic adaptation.

Proposition 5.

Resource flexibility mediates the relationship between financial optionality and organizational growth, such that financial optionality contributes to growth primarily through its ability to facilitate effective organizational resource reconfiguration.

The proposed propositions collectively explain how financial resources evolve into strategic capabilities through sequential causal relationships that connect environmental uncertainty, organizational adaptation, and sustainable growth within the proposed theory.

Table 3. Summary of Conceptual Propositions

	Proposition & Core Theoretical Logic	Primary Theoretical Foundation	Expected Outcome
P1	Environmental volatility increases the strategic value of preserving executable financial choices.	Real Options Theory	Greater financial optionality
P2	Financial flexibility provides the financial capacity required to develop financial optionality.	Corporate Finance (Financial Flexibility)	Development of financial optionality
P3	Financial optionality enhances managerial discretion to redeploy and reconfigure organizational resources.	Dynamic Capabilities; Resource Orchestration	Greater resource flexibility
P4	Resource flexibility enables timely strategic adaptation that supports sustainable organizational growth.	Strategic Flexibility; Dynamic Capabilities	Organizational growth

	Proposition & Core Theoretical Logic	Primary Theoretical Foundation	Expected Outcome
P5	Resource flexibility mediates the relationship between financial optionality and organizational growth.	Integrative Middle-Range Theory (Proposed)	Financial optionality contributes indirectly to organizational growth

Source: Developed by the author based on Bowman and Hurry (1993), Gamba and Triantis (2008), Denis (2011), Teece et al. (1997), Sirmon et al. (2007, 2011), Trigeorgis and Reuer (2017), and the conceptual synthesis developed in this study.

Table 3 synthesizes the proposed theoretical relationships into a coherent explanatory sequence. Rather than representing independent hypotheses, the propositions collectively describe the causal logic through which environmental volatility increases the value of financial optionality, enabling resource flexibility that ultimately supports organizational growth. Together, these propositions constitute the foundation of the proposed middle-range theory and guide its subsequent formalization in the following section.

The proposed propositions collectively establish financial optionality as the central explanatory mechanism linking financial capacity to organizational adaptation. By integrating previously fragmented perspectives from corporate finance and strategic management, the framework provides a coherent causal explanation of how organizations transform financial resources into sustainable organizational growth under persistent environmental volatility.

4. Proposed Middle-Range Theory

4.1 Introducing the Theory of Financial Optionality

The preceding sections demonstrate that existing theories provide only partial explanations of how organizations respond to environmental volatility. Real Options Theory explains the value of preserving future strategic choices, Financial Flexibility explains the preservation of financing capacity, Strategic Flexibility explains organizational responsiveness, and Dynamic Capabilities explain resource reconfiguration. However, none explicitly explains how financial resources are transformed into executable strategic choices that continuously support organizational adaptation. This theoretical fragmentation motivates the development of a middle-range theory of Financial Optionality.

A middle-range theory seeks to explain a specific organizational phenomenon through clearly defined constructs, mechanisms, and boundary conditions rather than providing universal explanations. Accordingly, the proposed theory focuses specifically on organizations operating under persistent environmental volatility, where strategic success depends on maintaining flexibility before uncertainty is resolved. Within this domain, financial optionality is conceptualized as the organizational capability to deliberately generate, preserve, and selectively exercise multiple financing, investment, and resource-allocation alternatives. Unlike conventional financial flexibility, which represents the availability of financial capacity, financial optionality emphasizes managerial discretion in preserving future strategic choices. Consistent with the conceptual distinction outlined in the reference framework, financial flexibility serves as an enabling condition, whereas financial optionality represents the capability that transforms financial capacity into strategic action.

This theoretical repositioning shifts attention from financial resources as static assets toward financial resources as dynamic strategic options. Consequently, organizational advantage no longer depends solely on the quantity of available financial resources but on the firm's capability to continuously maintain and activate alternative strategic pathways as environmental conditions evolve.

4.2 Explanatory Logic of the Theory

The explanatory logic of the proposed theory is grounded in the sequential interaction among environmental volatility, financial flexibility, financial optionality, resource flexibility, and organizational growth. Environmental volatility increases uncertainty regarding investment returns, financing availability, technological trajectories, and competitive behavior (Dess & Beard, 1984; Milliken, 1987). Under such conditions, organizations face increasing risks associated with irreversible commitments and rigid resource allocation.

Financial flexibility provides the financial foundation required to cope with uncertainty by preserving liquidity, borrowing capacity, and financing discretion (Denis, 2011; Gamba & Triantis, 2008). However, financial flexibility alone cannot explain why organizations possessing similar financial resources often display markedly different adaptive performance. The proposed theory argues that this variation emerges because firms differ in their ability to transform financial capacity into executable strategic choices.

Financial optionality is the central explanatory mechanism. Organizations with greater financial optionality maintain flexible financing, staged investments, redeployable capital, and reversible commitments, preserving multiple strategic pathways until uncertainty declines. This enhances managerial discretion, reduces premature commitment costs, and extends real options logic from investment valuation to organizational capability development (Bowman & Hurry, 1993; Trigeorgis & Reuer, 2017).

The exercise of financial optionality subsequently generates resource flexibility. Financial resources can be redirected toward innovation, acquisitions, market expansion, technological upgrading, or organizational restructuring depending on emerging environmental conditions. Through this process, financial optionality enables continuous resource orchestration, thereby strengthening the adaptive processes emphasized by Dynamic Capabilities Theory (Sirmon et al., 2011; Teece, 2007). Organizational growth ultimately results not from accumulated financial reserves alone but from the organization's capability to continuously convert preserved financial choices into effective strategic responses.

The explanatory mechanism unfolds through a sequential process in which financial capacity is progressively transformed into adaptive organizational capabilities that ultimately support sustained growth under environmental uncertainty.

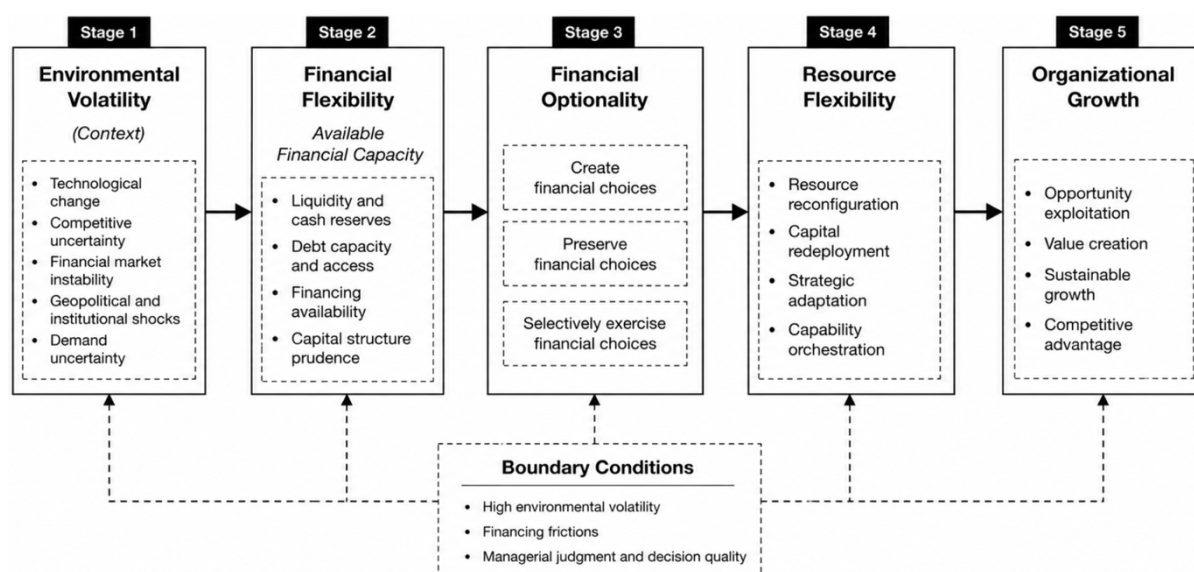


Figure 1. Causal Mechanism Linking Environmental Volatility, Financial Optionality, Resource Flexibility, and Organizational Growth

Source: Developed by the author based on Real Options Theory, Financial Flexibility, Dynamic Capabilities, Resource Orchestration, and the conceptual mechanism proposed in this study.

Figure 1 illustrates the sequential causal mechanism proposed by the theory. Rather than depicting static relationships among constructs, it explains how environmental volatility initiates a process through which financial flexibility enables financial optionality, which is subsequently translated into resource flexibility and organizational growth. The figure also highlights the boundary conditions that strengthen or constrain this adaptive mechanism across different organizational contexts.

4.3 Boundary Conditions and Expected Outcomes

The explanatory power of the proposed theory depends upon several contextual conditions that define its domain of applicability.

First, environmental volatility represents the primary boundary condition. The value of preserving multiple financial options increases as uncertainty regarding markets, technology, regulation, or financing conditions becomes more pronounced. Under relatively stable environments, organizations can predict future outcomes with greater confidence, reducing the strategic benefits associated with maintaining numerous alternative financial choices. Consequently, financial optionality should exert its strongest influence in highly dynamic industries characterized by continuous environmental change.

Second, financing frictions strengthen the importance of financial optionality. When access to external capital becomes costly or uncertain, firms possessing greater optionality retain superior capacity to continue investing while competitors experience resource constraints (Campello et al., 2010; Favara et al., 2021; Fazzari et al., 1988). Under these circumstances, preserving alternative financing pathways becomes a strategic source of competitive advantage rather than merely a financial safeguard.

Third, managerial judgment determines whether preserved financial options are exercised effectively. Maintaining numerous financial alternatives does not automatically create value unless managers accurately interpret environmental signals and select appropriate strategic responses. Consequently, managerial cognition represents an implicit microfoundation supporting the successful execution of financial optionality (Helfat & Peteraf, 2015).

Within these boundary conditions, organizations exhibiting stronger financial optionality are expected to demonstrate greater resource flexibility, more adaptive investment behavior, enhanced strategic responsiveness, and ultimately superior organizational growth during periods of persistent environmental volatility.

4.4 Formal Theory Statement

The proposed middle-range theory may be formally stated as follows:

Organizations operating in volatile environments achieve superior organizational growth when financial flexibility is transformed into financial optionality, enabling managers to preserve and selectively execute multiple financing, investment, and resource-allocation choices. Through the exercise of these choices, financial optionality enhances resource flexibility, allowing organizations to continuously reconfigure strategic resources in response to changing environmental conditions. The effectiveness of this mechanism increases under conditions of high environmental volatility, significant financing frictions, and effective managerial judgment.

This theory contributes to the literature in three important ways. First, it extends Real Options Theory by repositioning option value from individual investment decisions to an organization-level capability. Second, it reconnects corporate finance and strategic management by explaining how financial capacity evolves into adaptive organizational behavior through resource flexibility. Third, it introduces financial optionality as a distinct theoretical construct rather than a synonym for financial flexibility, thereby addressing an important conceptual

gap identified in the existing literature and establishing a new explanatory mechanism linking financial capacity with sustainable organizational growth.

The proposed theory can be synthesized into an integrated conceptual architecture that illustrates the relationships among its principal constructs and clarifies the overall explanatory logic underlying organizational adaptation.

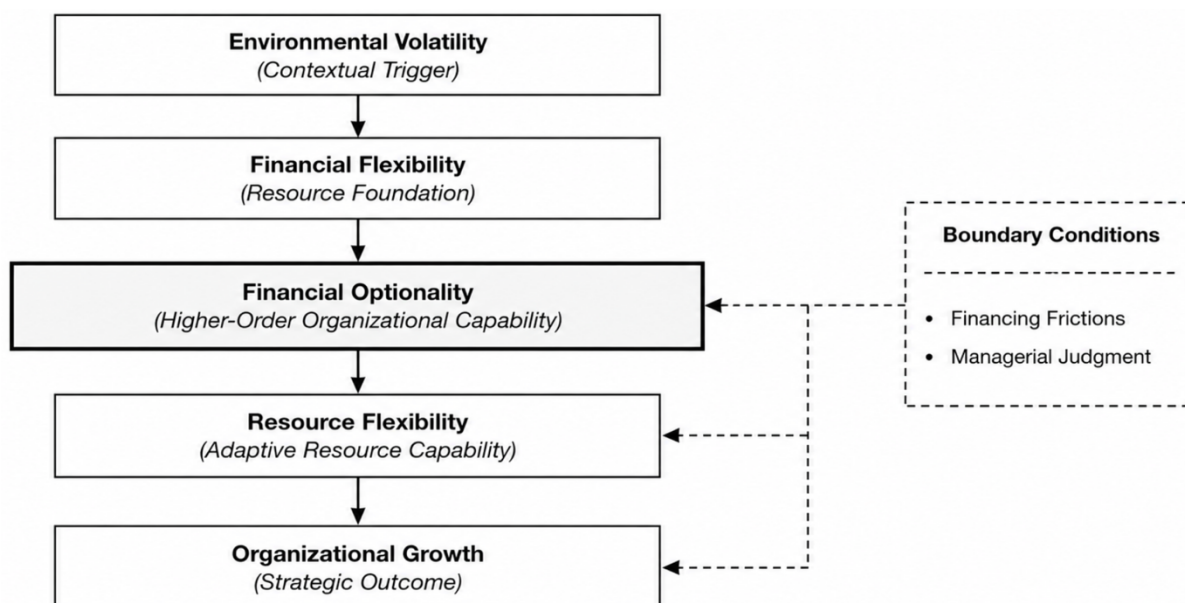


Figure 2. Proposed Middle-Range Theory of Financial Optionality

Source: Developed by the author based on Real Options Theory, Financial Flexibility, Dynamic Capabilities, Resource Orchestration, and the conceptual synthesis proposed in this study.

Figure 2 presents the overall architecture of the proposed middle-range theory by positioning financial optionality as the central organizational capability linking financial flexibility with resource flexibility and organizational growth. It also identifies environmental volatility as the contextual trigger and recognizes financing frictions together with managerial judgment as boundary conditions influencing the effectiveness of the proposed theoretical relationships.

The proposed theory therefore explains organizational growth not as a direct consequence of possessing financial resources, but as the outcome of an organization's capability to preserve, activate, and orchestrate financial choices before uncertainty is resolved. This capability-based perspective differentiates financial optionality from existing finance constructs while providing an integrative explanation that bridges the traditionally separate domains of corporate finance and strategic management.

5. Discussion

5.1 Theoretical Implications

The proposed theory contributes to the literature by integrating several theoretical traditions that have largely evolved independently. Existing corporate finance research has established that financial flexibility enhances organizational resilience through liquidity, borrowing capacity, and financing discretion (Denis, 2011; Gamba & Triantis, 2008; Rapp et al., 2014). At the same time, strategic management literature has demonstrated that organizations achieve superior performance by maintaining strategic flexibility, dynamically reconfiguring resources, and orchestrating organizational capabilities under changing environmental conditions (Brozovic, 2018; Sirmon et al., 2007a; Teece, 2007). Despite these advances, neither stream has fully explained the organizational mechanism through which financial resources are converted into adaptive strategic action.

The present study addresses this theoretical gap by positioning financial optionality as the missing capability that connects financial flexibility with resource flexibility and organizational growth. This reconceptualization extends Real Options Theory beyond its traditional emphasis on individual investment decisions toward an organization-level capability that continuously generates and preserves future strategic choices (Bowman & Hurry, 1993; Trigeorgis & Reuer, 2017). Consequently, the proposed theory shifts the focus of corporate finance from optimizing financial structure toward understanding how financial resources create enduring strategic discretion under environmental volatility.

The theory also advances Dynamic Capabilities research by explicitly incorporating financial capacity into the resource reconfiguration process. Previous studies generally assume that organizations possess deployable resources before sensing, seizing, and transforming opportunities (Helfat & Peteraf, 2015; Teece, 2007). The proposed framework demonstrates that the preservation and activation of financial choices constitute an important antecedent of resource orchestration. Financial optionality therefore enriches the microfoundations of organizational adaptation by identifying financial decision architecture as a capability that enables subsequent strategic renewal.

Finally, the proposed middle-range theory contributes conceptually by distinguishing financial flexibility from financial optionality, a distinction emphasized in the reference framework supporting this study. Rather than viewing the two concepts as interchangeable, the theory positions financial flexibility as an enabling resource condition and financial optionality as a higher-order capability that transforms financial capacity into executable strategic alternatives. This distinction provides a clearer conceptual foundation for future theoretical development and empirical investigation.

5.2 Managerial Implications

The proposed theory offers several implications for strategic decision-makers operating in volatile business environments. Conventional financial management often evaluates liquidity, debt capacity, and cash holdings primarily from the perspective of financial efficiency. The present framework suggests that these resources should also be viewed as strategic assets whose value depends on their ability to preserve future organizational choices.

Managers should therefore design financial policies that maximize strategic discretion rather than merely minimize financing costs. Maintaining diversified financing channels, preserving borrowing capacity, structuring staged investments, and avoiding irreversible resource commitments can increase organizational adaptability when environmental conditions change unexpectedly. Financial resources should be managed not simply as precautionary reserves but as mechanisms for sustaining multiple strategic pathways that can be activated selectively as uncertainty unfolds.

The theory further implies that strategic planning and financial planning should become more closely integrated. Decisions regarding liquidity management, capital structure, investment sequencing, and resource allocation should be evaluated according to their contribution to organizational optionality. Organizations capable of preserving financial choices are expected to respond more rapidly to emerging opportunities, technological disruption, competitive shifts, and unexpected crises than organizations whose financial structures constrain managerial discretion.

5.3 Boundary Conditions and Limitations

Several limitations define the scope of the proposed theory. First, the framework is intentionally conceptual and therefore does not empirically validate the proposed relationships. Future empirical studies are required to operationalize financial optionality as

a measurable organizational construct and examine the proposed propositions across different industrial and institutional contexts.

Second, the theory is primarily intended for organizations operating under persistent environmental volatility. Its explanatory power may be weaker in highly stable industries where uncertainty is relatively low and future strategic conditions are more predictable. Under such circumstances, maintaining extensive financial options may generate opportunity costs that outweigh their strategic benefits.

Third, the present framework emphasizes financial mechanisms while recognizing that organizational adaptation is also influenced by leadership, organizational culture, governance structures, technological capability, and institutional conditions. These factors may strengthen or weaken the effectiveness of financial optionality and therefore represent important contextual moderators rather than explicit components of the proposed theory.

Finally, although the theory integrates corporate finance and strategic management, it does not seek to replace established theories such as Real Options Theory or Dynamic Capabilities. Instead, it positions financial optionality as an integrative mechanism that complements these theories by explaining how financial capacity becomes an organizational capability supporting adaptive resource deployment.

5.4 Future Research Agenda

The proposed middle-range theory opens several promising directions for future research. First, future studies should develop reliable measurement scales for financial optionality that distinguish it empirically from financial flexibility, liquidity, financial slack, and organizational resilience. Such measurement development represents a necessary step toward testing the proposed theoretical model.

Second, empirical research should investigate the mediating role of resource flexibility using multiple organizational contexts, including manufacturing, technology-intensive industries, entrepreneurial ventures, and multinational corporations. Comparative analyses across different institutional environments would further clarify the boundary conditions under which financial optionality creates the greatest strategic value.

Third, future research should examine potential moderators beyond those proposed in this article, including organizational governance, managerial cognition, digital transformation, innovation capability, and ecosystem complexity. These variables may explain why organizations with similar financial capacity differ substantially in their ability to convert financial resources into adaptive strategic action.

Finally, the theory may serve as a foundation for extending research at the intersection of corporate finance and strategic management. Future studies could integrate financial optionality with emerging perspectives such as organizational resilience, strategic agility, sustainable growth, and ecosystem adaptation. Such extensions would further refine the proposed middle-range theory while broadening its explanatory relevance across diverse organizational settings.

The proposed theory also provides a structured research agenda by identifying promising directions for construct refinement, empirical validation, contextual extension, and broader theoretical integration across organizational settings.

Table 4. Future Research Agenda for Financial Optionality Theory

Research Priority	Key Research Question	Suggested Research Design	Expected Contribution
Construct Development	How can financial optionality be conceptualized and measured as a distinct organizational capability?	Scale development and validation	Establish construct validity and distinguish financial optionality from financial flexibility.

Research Priority	Key Research Question	Suggested Research Design	Expected Contribution
Theory Validation	Do the proposed relationships and mediating mechanism hold across different organizational contexts?	Longitudinal studies, SEM, or panel-data analysis	Empirically validate the proposed middle-range theory.
Boundary Conditions	Under which environmental and institutional conditions is financial optionality most valuable?	Cross-industry and cross-country comparative studies	Refine the theory's domain of applicability and contextual boundaries.
Theory Extension	How does financial optionality interact with organizational resilience, strategic agility, digital transformation, and innovation capability?	Integrative conceptual and empirical research	Expand the explanatory scope of financial optionality within strategic management and corporate finance.

Source: Developed by the author based on the future research agenda proposed in this study.

Table 4 consolidates the principal opportunities for advancing the proposed theory. The suggested research directions extend beyond empirical testing by encouraging refinement of construct validity, examination of contextual boundary conditions, and integration with complementary strategic perspectives. Collectively, these priorities provide a coherent roadmap for transforming financial optionality from a conceptual framework into a cumulative program of theory development and empirical inquiry.

Overall, the proposed theory contributes not only by introducing a new conceptual construct but also by establishing a coherent research agenda capable of advancing dialogue between corporate finance and strategic management. By positioning financial optionality as the mechanism through which financial capacity is transformed into adaptive resource flexibility, the framework provides a theoretically grounded explanation for how organizations sustain growth amid persistent environmental volatility.

6. Conclusion

This study addresses a persistent theoretical problem at the intersection of corporate finance and strategic management concerning the insufficient explanation of how financial resources are transformed into adaptive organizational capabilities under conditions of environmental volatility. Although prior research has established the value of financial flexibility in preserving financing capacity and has separately demonstrated the importance of strategic flexibility, dynamic capabilities, and real options for organizational adaptation, these streams have largely evolved in parallel and provide only partial explanations of the relationship between financial resources and sustained organizational growth. The objective of this study was therefore to develop a middle-range theory that integrates these fragmented perspectives by conceptualizing financial optionality as the organizational capability that converts financial capacity into executable strategic choices through resource flexibility.

The primary novelty of this study lies in the introduction and theoretical positioning of financial optionality as a distinct higher-order organizational capability rather than a synonym for financial flexibility. By distinguishing financial flexibility as an enabling financial condition from financial optionality as the capability to create, preserve, and selectively exercise financing, investment, and resource-allocation choices, the proposed theory extends existing conceptualizations within both corporate finance and strategic management. More importantly, the study advances current knowledge by identifying resource flexibility as the central explanatory mechanism through which financial optionality contributes to organizational growth. This conceptual repositioning shifts scholarly attention from viewing

financial resources as passive reserves toward understanding them as strategic assets that generate adaptive organizational discretion under uncertainty.

The proposed framework, causal mechanism, and five interrelated propositions further extend the literature by integrating insights from Real Options Theory, Financial Flexibility, Dynamic Capabilities, and Resource Orchestration into a coherent explanatory architecture. Rather than replacing these established theories, the proposed middle-range theory synthesizes their complementary strengths while addressing the conceptual gap that none independently explains how financial capacity evolves into adaptive organizational behavior. By specifying the sequential relationships among environmental volatility, financial flexibility, financial optionality, resource flexibility, and organizational growth, the study provides a theoretically grounded explanation of organizational adaptation that is both conceptually parsimonious and sufficiently bounded to facilitate future theoretical refinement and empirical investigation.

Beyond its theoretical contributions, the proposed framework offers important managerial implications. It suggests that organizations should evaluate financial policies not solely in terms of liquidity preservation or financing efficiency but also according to their ability to maintain strategic discretion under uncertainty. Financial decision-making, investment planning, and resource allocation should therefore be designed to preserve multiple executable strategic alternatives rather than simply maximize short-term financial performance. Such an orientation may strengthen organizational adaptability in environments characterized by persistent volatility, financing constraints, and rapid technological or competitive change.

Several limitations should be acknowledged. As a conceptual study, the proposed theory has not yet been subjected to empirical validation, and the financial optionality construct requires rigorous operationalization and measurement before its explanatory power can be systematically assessed. Furthermore, the theory is intentionally bounded to organizational contexts characterized by elevated environmental volatility and financing frictions, and its applicability to relatively stable environments may therefore be more limited. Future research should develop validated measurement instruments for financial optionality, examine the proposed causal relationships using longitudinal and multi-context empirical designs, investigate additional boundary conditions and moderators, and explore the integration of financial optionality with related perspectives such as organizational resilience, strategic agility, digital transformation, and ecosystem adaptation.

Overall, this study demonstrates that understanding organizational adaptation requires moving beyond the preservation of financial resources toward explaining how organizations deliberately transform financial capacity into executable strategic choices. By introducing financial optionality as the missing theoretical link between financial flexibility, resource flexibility, and organizational growth, the proposed middle-range theory contributes a new conceptual foundation for bridging corporate finance and strategic management. As organizations continue to operate in increasingly volatile environments, this capability-based perspective offers a promising direction for advancing theory development while providing a richer explanation of how firms achieve sustained strategic adaptation and long-term organizational growth under uncertainty.

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