Business Growth Management and The Dynamic Capabilities Concept

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Abstract

The paper aims to examine the specifics of the business growth management from the dynamic capabilities' perspective. Firm growth has to be considered and analysed as a whole process rather than as a single action. The main objective of the paper is to examine the relation between firm performance and growth and the dynamic capabilities. The general assumption is that the creation and development of dynamic capabilities influence positively the business growth management processes. Dynamic capabilities reveal some common issues across firms. Those companies that intend to grow, may use their dynamic capabilities to better reconfigure their internal resources, better detect and exploit external opportunities.

Keywords: dynamic capabilities, business growth, organisations, SMEs

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Introduction

Business growth is not only important for organisations, but also essential and challenging to them to achieve, sustain and manage it. The notion of growth means various things to organisations, such as an increase of a given indicator (number of employees, turnover/ sales, assets, etc.), stage or phase of the company's development life cycle. The alternative of growth is stagnation, so companies try to formulate and follow their growth strategies to compete successfully.

The main objective of the paper is to examine business growth from the dynamic capabilities perspective. After discussing the specifics of business growth management, we will explain it applying the dynamic capabilities perspective (DCP). The general assumption is that the creation and development of dynamic capabilities influence positively the business growth management processes.

Competition forces drive companies to adapt, renew, reconfigure and recreate their resources and capabilities in line with the competitive environment. Competitiveness is crucial for each company to survive and grow at the marketplace. The idea of dynamic capabilities has its roots in previously used terms such as distinctive competences, organisational routine, architectural knowledge, core competences, core capabilities and rigidity.

Business growth management

Most definitions of the term growth are based on the relationship between the quantitative increase and qualitative changes of the main resources and company goals. Business growth can be defined as an increase of the firm size caused by quantitative increase of the productive resources as well as the degree of their effective use. So, the sales increase leads to a higher profitability of the capital invested and the market value of the firm. The firm growth is a long-term, quantitative and qualitative change of the firm resources and performance.

Despite the fact that each firm development is unique and occurs at different rate, there are certain similarities of the general firm development model, which can be depicted as consequent stages of evolutionary growth, decline and stagnation. Unlikely any other living creatures that have predetermined growth, firms are social entities and their activities depend on their participants. The complex and competitive environment influences firm performance and it may stimulate business growth, but it is not obligatory. In some cases, companies may choose not to grow, even to downsize. Adaptation to changes is vital for firm survival and successful operation.

Firm growth has to be considered and analysed as a whole process rather than as a single action. In that sense the relationship between business growth and company goals is an essential part of the overall growth analysis. Regarding small and medium-sized enterprises (SMEs) in most cases their goals reflect owner's/ manager's motives for firm establishment and further development.

In general, the company registers growth, if the actually achieved results exceed the starting position indicators. Usually among the widely used firm growth indicators are the employee number, market share, equity capital, turnover, profit, profitability, efficiency, financial statement indicators, etc. Universal definition of the term firm growth will be quite unclear and it is hardly to be proposed unless the specific firm and industry characteristics are not considered as it is possible that qualitative changes may occur during the growth process. According to Edith Penrose (1995: 19) „*…the differences in the administrative structure of the very small and the very large firms are so great that in many ways it is hard to see that the two species are of the same genus. We cannot define a caterpillar and then use the same definition for a butterfly*".

Obviously a set of indicators has to be proposed as a growth measurement because a single indicator cannot fully describe the business growth and its specifics. Actually the growth of the company is not the key corporate goal. Growth is a means for achieving higher value added and guaranteeing the survival of the firm in the long term. However, prolonged absence of growth may be a symptom of future decline (Canals, 1999).

The growth process is a result of the interaction of various factors. Depending on their influence, these factors can be grouped as growth stimulating, growth retaining and growth hindering factors. According to the direction of their influence, the growth factors can be defined broadly as external and internal factors. Regarding the business growth management of SMEs, the most common growth factor groups are the following (Storey, 1994):

- Entrepreneurial characteristics
- External environment characteristics
- Firm resources and characteristics
- Business strategy

Each factor group comprises particular components. Prerequisite for a successful and healthy growth is the harmony and congruence of the factor groups as well as within each factor group. The *entrepreneur* can be characterised by his/ her personal goals and traits, motivation, behaviour, professional experience, risk propensity, etc. Actually, vision and evaluation of success are quite subjective terms and not always correspond to the firm growth. However, the entrepreneur determines the *desired growth* of the firm and its strategic direction (Figure 1). He/ She determines the firm goals and criteria for achieving. The growth path and the interdependence of growth factors are presented in the conceptual growth model.

The *external environment* cannot be viewed as homogeneous. The macro-regulations as well as the market specifics and competition rates determine the initial conditions such as the growth stimuli and set the growth constraints when executing the growth strategy. On the other hand, the *real/ accomplished growth* is influenced by the existing growth constraints and depend on the growth strategy of the firm.

Firm characteristics include its age, size, location, ownership as well as the variety of resources such as personnel, technology, financial ones, stock and inventories, information systems, etc. In general, they all contribute to the growth potential of the firm and similarly to the external environment determine growth stimuli and constraints along the firm growth path. *Growth strategy* as a growth factor reflects the managerial skills and style of the entrepreneur. It can be seen as a link between the desired growth and the growth potential and the real growth reached by the company, on the other hand.

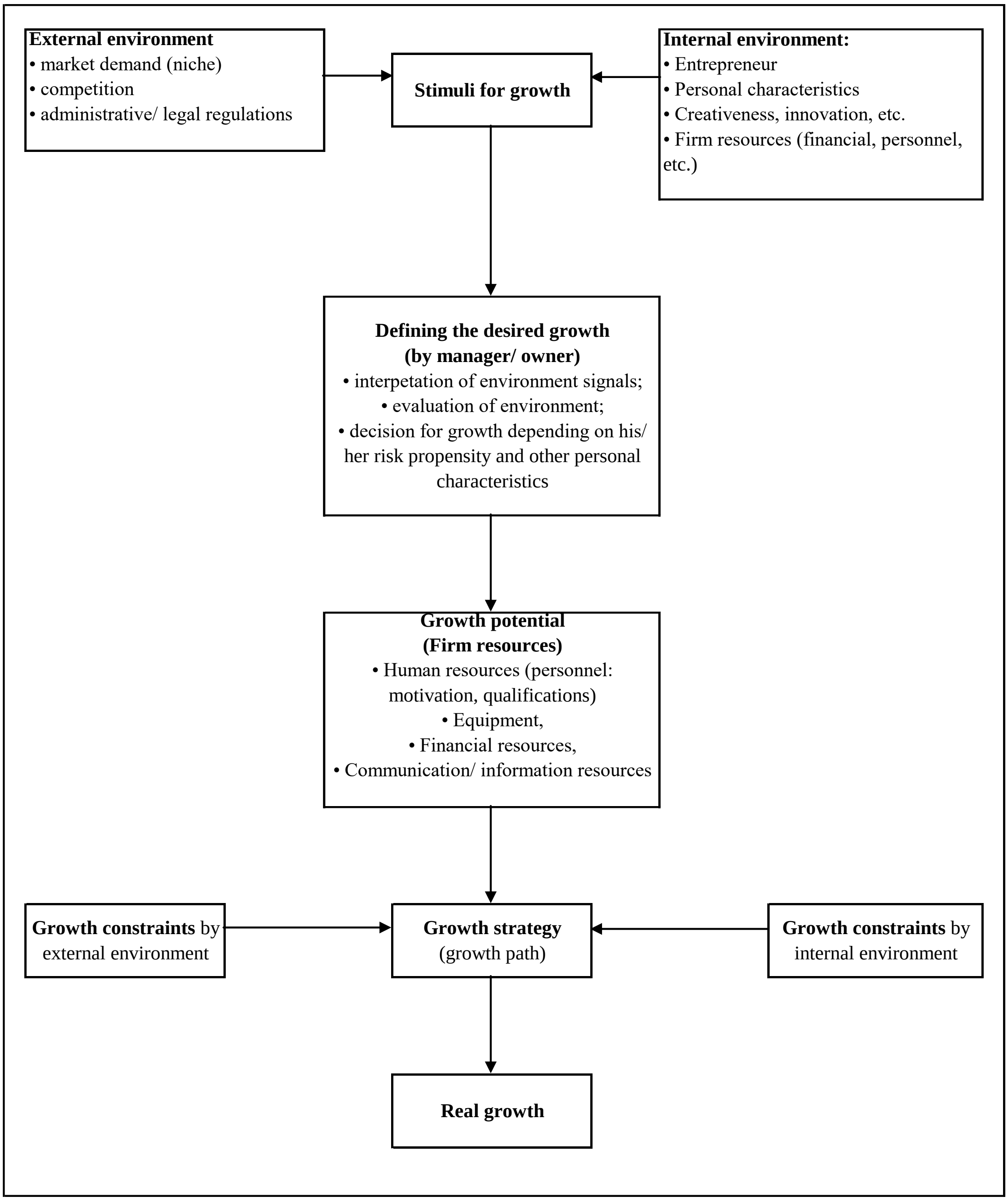

Figure 1. Conceptual growth model – firm growth factors and growth path

Dynamic capabilities concept and perspective

It is argued that in theory dynamic capabilities reveal some common issues across firms. *Dynamic capabilities* are referred by researchers to a wide range of resources, processes and capabilities. There is a mixed use and interpretation of their terminology. On the other hand, empirical studies in this field are based exclusively on case studies and focus primarily on firm- or industry-specific processes. Nevertheless, this concept and theory has become dominant in the field of strategic management of organisations. The provided theoretical framework can be used for explaining not only the creation of new enterprises but also the growth and development of existing ones (Newbert, 2005).

The DCP has emerged with the contributions of Teece et al. (1997) as a complement to the resource-based view (RBV) of the firm in order to explain how firms adjust capabilities in rapidly changing markets. DCP refers to the ability of a firm to achieve new forms of competitive advantage be renewing competences – organizational resources – to achieve congruence with the changing business environment. This capability is *dynamic* because the firm must continually build, adapt, and reconfigure internal and external competences to achieve congruence with the changing business environment when time-to-market and product timing are critical, the rate of technological change is rapid, and the nature of future competition and markets are difficult to determine.

According to Teece (2007) the aim of dynamic capabilities research is to understand how firms can sustain a competitive advantage by responding to and creating environmental change. The illustration of this dynamic capabilities model is represented in figure 2.

The definition focuses on particular types of dynamic capabilities – opportunity identification (sensing) and investments in these opportunities (seizing) lead to new positions and paths recombination and reconfiguration. A possible effect could be firm performance changes in terms of growth, profits and competitive advantage. Subsequent to investment, dynamic capabilities for recombination and reconfiguration can alter the accumulated asset base of the organization further, leading to an additional effect on firm performance and competitive advantage, and to new positions and paths. Helfat, et al. (2009) compare the most dominant definitions and its implications for firm performance and competitive advantages.

Actually, the earliest definition of dynamic capabilities by Teece et al. (1997) shows that prior paths such as firm history and previous investments, for example, lead to current firm positions (tangible and intangible assets). Dynamic capabilities lead to new paths and positions of the organisation, possible changes of the firm performance and competitive advantage.

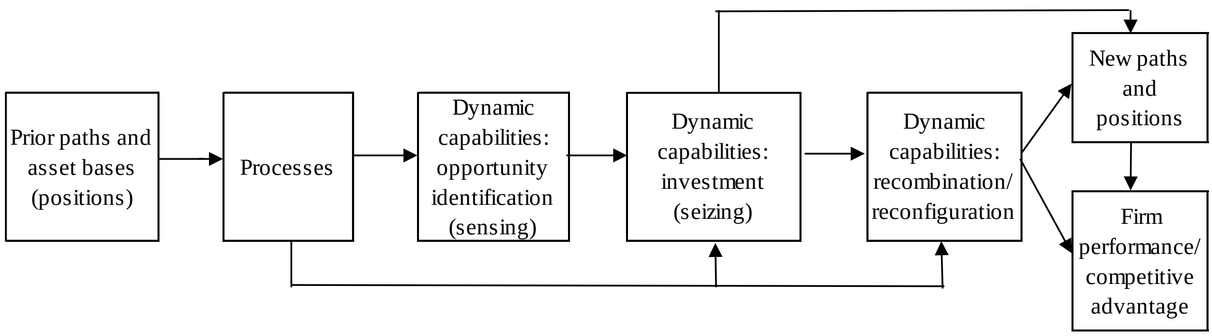

Figure 2. Dynamic capabilities model according to Teece (2007)

Helfat et al. (2007) try to define capabilities and resources in order to clarify inherent problems of dynamic capabilities view. Moreover, they argue that dynamic capabilities contribute to firm growth. Dynamic capabilities may enable firms to survive and maintain their scale and scope in the face of change, but without necessarily growing. This perspective is fully consistent with the original emphasis of Teece et al. (1997), mentioned above – "the ability to match the requirements of a changing environment".

Another approach to explaining dynamic capabilities is suggested by Eisenhardt and Martin (2000). They describe dynamic capabilities as processes that firms can use to obtain, integrate, reconfigure and release resources (Figure 3). It will lead to new resources and resource reconfigurations. According to them dynamic capabilities have a direct effect on firm performance and competitive advantage, as well as an indirect effect through resource reconfiguration.

Although Eisenhardt and Martin (2000) view competitive advantage as more difficult to achieve through dynamic capabilities in comparison to Teece, they have a similar logic regarding dynamic capabilities and firm performance. The authors evaluate dynamic capabilities as a necessary but not sufficient condition for competitive advantage. Firms may use them specifically to develop and employ them later to pursue different types of competitive advantages.

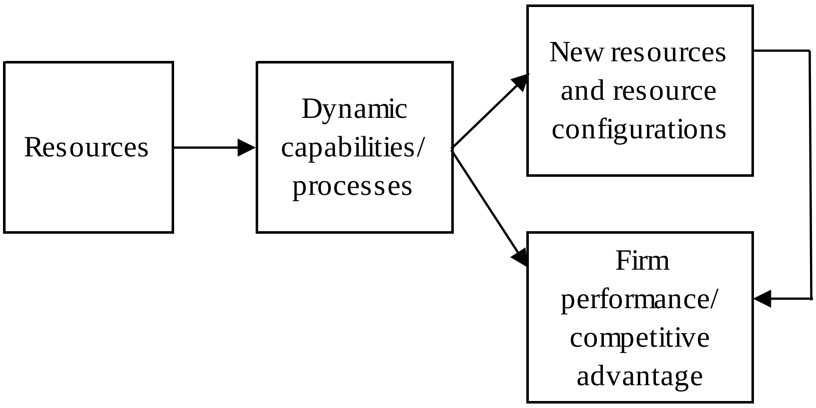

Figure 3. Dynamic capabilities model according to Eisenhardt and Martin (2000)

Understanding the link between dynamic capabilities, firm performance and competitive advantage requires a more general understanding of the distinction between firm performance and competitive advantage. Dynamic capabilities are not in themselves a source of long-term competitive advantage. They reveal means of achieving resource configurations that provide advantage. This suggests that dynamic capabilities are simply processes and therefore does not lend us further understanding of the distinction between dynamic capabilities and processes. Dynamic capabilities create resource configurations that generate value-creating growth strategies. Their advantage lies in applying them before their competitors and rivals.

Winter (2003) proposed that clarity is served by breaking the link between dynamic capabilities and competitive advantage. This post-success identification is problematic as it infers dynamic capabilities are a construct only for successful firms. It may even be proposed that dynamic capabilities do not guarantee success or survival (Zahra et al., 2006).

Business growth research model from dynamic capabilities perspective

In case a research study identifies component factors of dynamic capabilities it would guide the development of actionable prescriptions or practical tools and techniques for managers to utilise for the purpose of improved performance. Wang (2007) define dynamic capabilities as a *firm's behavioural orientation to constantly integrate, reconfigure, renew and recreate its resources and capabilities, and most importantly, upgrade and reconstruct its core capabilities in response to the changing environment to attain and sustain competitive advantage*. Wang, Ahmed proposed a research model for dynamic capabilities (Figure 4) incorporating market dynamism as an antecedent to, and capability development and firm performance as consequences of, dynamic capabilities.

The nature of dynamic capabilities varies with market dynamism. In moderately dynamic markets these capabilities resemble organizational routines that rely on existing knowledge and linear execution to produce predictable outcomes. In highly dynamic markets and traditional markets, knowledge- and learning –based mechanisms guide to evolution of dynamic capabilities and underlie path dependence in acquiring, reconfiguring, and integrating resources. Dynamic capabilities can be viewed as combinations of "simpler capabilities" and their related routines. In these combinations, "sequence steps" imply a temporal order for developing these simpler capabilities or for their interaction in practice.

According to them firm-level dynamic capabilities encompass three component factors (*adaptive, absorptive and innovation capability*), which are common among the firms and industries. There are underlying processes such as *integration, reconfiguration, renewal and recreation of resources*, which are specific for each company. Firm performance is evaluated by market-based and financial performance. The dashed lines show indirect relationship. The most important component factors of dynamic capabilities and underpin a firm's ability to integrate, renew and recreate its resources and capabilities in line with external changes. These three factors are correlated but conceptually distinct.

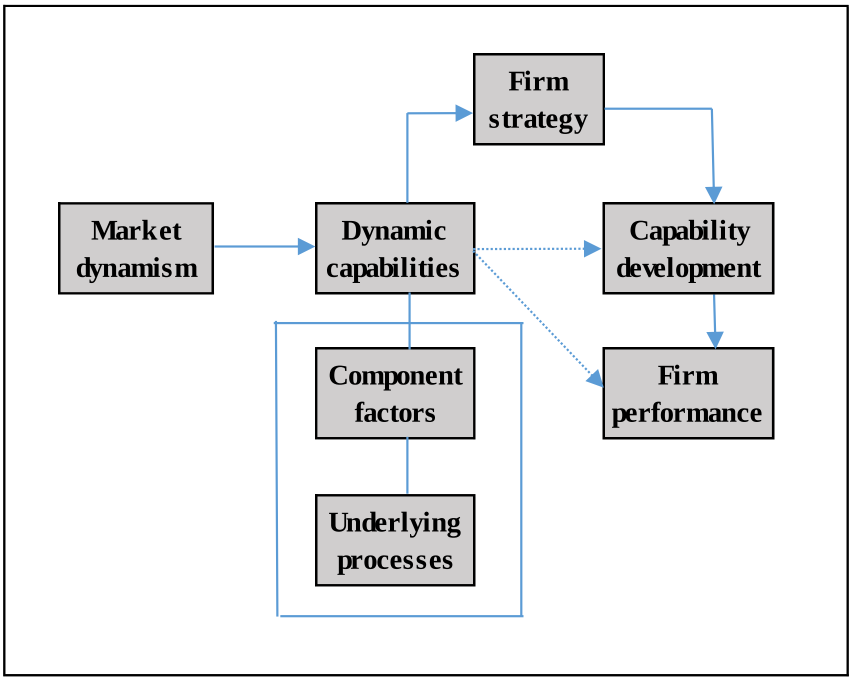

Figure 4. Research model for dynamic capabilities, proposed by Wang et al. (2007)

Discussion and results

Recent arguments in the dynamic capabilities literature suggest that firms need to develop skills in both internal development and external sourcing to be able to renew their capabilities and thrive over time. Yet firms often struggle to discriminate between conditions that suit internal development and those that suit external sourcing. When firms are dynamically competitive, business growth management will be active at sensing and seizing opportunities. Path dependencies exist but are not inexorable. Organizations both adapt and help shape their environments.

Although we have a growing understanding of the conditions under which internal development and external sourcing are most appropriate, questions remain concerning the nature of such contingencies and firms' ability to select modes of sourcing new capabilities. It is still under-examined the extent to which firms' ability to select appropriate modes of capability sourcing, and thereby form coherent portfolios of internal and external sourcing projects, improves their ability to create new capabilities and to survive in dynamic environments.

The emergence of dynamic capabilities has enhanced the business growth management by addressing the evolutionary nature of firm resources and capabilities in relation to environmental changes and enabling identification of firm- or industry- specific processes that are critical to firm evolution. Those companies that intend to grow, may use their dynamic capabilities to better reconfigure their internal resources, better detect and exploit external opportunities.

Dynamic capabilities are imitable, can be developed through multiple learning paths, and have commonalities across firms and industries. The development of dynamic capabilities reflects management's ability to demonstrate timely responsiveness and rapid innovation and to effectively coordinate and redeploy internal and external resources or competencies based on managerial and organizational processes, market positions, and path dependencies.

Conclusion

If a firm possesses resources and competences but lacks dynamic capabilities, it has a chance to make a competitive return for a short period, but superior returns cannot be sustained. The possession and employment of dynamic capabilities provides the company with growth intentions with opportunities to better perform and generate superior profitability over longer period.

After examining the concept of business growth from the dynamic capabilities perspective we can conclude that their common features such as routine concept, learning and process perspectives influence the firm performance. Firms are trying to constantly integrate, reconfigure, renew, and recreate its resources and capabilities, and most importantly, upgrade and reconstruct its core capabilities in response to the changing environment to attain and sustain competitive advantage, which enables them to grow.

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