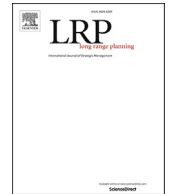




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Dynamic capabilities and firm performance

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ABSTRACT

This paper juxtaposes conflicting claims about the relationship between codified dynamic capabilities and firm performance at different levels of environmental dynamism. Furthermore, it argues that the contradictory propositions and findings in prior research are due to said relationship being contingent on key, yet thus far overlooked and unaccounted for, factors internal to the firm such as dynamism exposure and asset base complexity. Empirical tests in the context of the mutual funds industry provide evidence that the performance contribution of codified dynamic capabilities does decline as environmental dynamism increases, yet for any given level of environmental dynamism the magnitude and even the sign of the performance contribution of codified dynamic capabilities are significantly influenced by firms' dynamism exposure and asset base complexity. Going beyond received wisdom, this study advances a more nuanced contingency approach to dynamic capabilities which contributes to a better understanding of how the value of dynamic capabilities is shaped by a complex interplay of environmental and internal factors.

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Introduction

Since the publication of Teece, Pisano and Shuen's (1997) (TPS from here onwards) pioneering work on dynamic capabilities, dynamic capabilities research has become one of the most active areas of inquiry in the field of strategic management. Indeed, hundreds, if not thousands, of research papers, workshops, and conference sessions around the world have been dedicated to advancing our understanding of dynamic capabilities. Yet, in spite of the ample scholarly and practitioner interest and the high intensity of the research effort, substantial conceptual concerns and disagreements remain about core elements of the construct such as the very nature and performance consequences of dynamic capabilities (Barreto, 2010; Di Stefano et al., 2014; Helfat et al., 2007; Peteraf et al., 2013).

Recent work by Di Stefano, Peteraf and Verona (2014, 2013) has documented that the dynamic capabilities research domain has developed under the strong influence of two seminal papers – TPS and Eisenhardt and Martin (2000) (EM from here onwards) – that, while complementary in many respects, “represent not only differing but contradictory views of dynamic capabilities” (Peteraf et al., 2013: 1389). They concluded that the “differences between the two papers are such that, in essence, they represent two mutually exclusive approaches for framing dynamic capabilities” (Peteraf et al., 2013: 1389) with

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the differences being “starkest and most divergent in high-velocity environments” (Di Stefano et al., 2014: 317). The relationship between dynamic capabilities and firm performance in dynamic markets is an area where the conflict between the TPS and EM conceptions is particularly striking. While TPS portray dynamic capabilities as organizational routines which embody “learned organizational skill” (TPS: 521) supported by codification (TPS: 525) providing firms with the “ability to ... address rapidly changing environments” (TPS: 516), EM reject that view arguing instead that dynamic capabilities in the form of codified, analytic organizational routines will put firms at a disadvantage in high-velocity environments where the rapid creation of new situation specific knowledge through “simple, experiential, unstable processes” (EM: 1106) will be called for rather than the efficient application of codified knowledge accumulated from prior experience.

Given the stark contradiction in the literature, I juxtapose the opposing propositions of TPS and EM, and of subsequent research associated with the two perspectives, on the relationship between the performance contribution of codified dynamic capabilities and environmental dynamism. Furthermore, I argue that the mixed and contradictory findings and conclusions in extant research may be due to the above relationship being contingent (Burns and Stalker, 1961; Thompson, 1967) on thus far overlooked and unaccounted for heterogeneity in factors internal to the firm, specifically firms' dynamism exposure and asset base complexity. My empirical examination of the above propositions on a large sample of U.S. equity mutual funds over the period 1999 to 2009 provides evidence that the performance contribution of codified dynamic capabilities does decline as environmental dynamism increases, yet for any given level of environmental dynamism the magnitude and even the sign of the performance effect of codified dynamic capabilities are contingent on firms' dynamism exposure and asset base complexity.

This study contributes to research on dynamic capabilities in several ways. For one, extant research tends to be predominantly theoretical in nature or perform empirical analyses that do not address the fundamental contradictions between the TPS and EM conceptions of dynamic capabilities. This paper offers a direct empirical test of their contradictory propositions regarding the value of codified dynamic capabilities under environmental dynamism. Furthermore, I theorize and provide novel empirical evidence that this contested relationship is contingent on firm heterogeneity in dynamism exposure and asset base complexity, theoretically and empirically unaccounted for by prior research, which has a major influence on the magnitude and even direction of the performance effect of codified dynamic capabilities. This paper, thus, contributes a novel explanation for the mixed and contradictory findings reported in prior literature. It brings to the fore the significance of exploring how the value of codified dynamic capabilities is determined by a complex interplay of environmental and internal factors. In so doing, it answers the call of Peteraf et al. (2013) for contingency-based studies that help bridge the theoretical divide between TPS and EM and help further the theoretical integration of the field.

Theory and hypotheses

The influential recent work of Di Stefano, Peteraf and Verona (2014, 2013) has exposed a fundamental split in the literature on dynamic capabilities. Peteraf et al. (2013) first provided evidence that the dynamic capabilities research domain has developed under the strong influence of two fundamental papers (EM and TPS), far surpassing any other articles in terms of their influence and recognition, that, while complementary in many respects, “represent not only differing but contradictory views of dynamic capabilities” (Peteraf et al., 2013: 1389). They concluded that the “differences between the two papers are such that, in essence, they represent two mutually exclusive approaches for framing dynamic capabilities” (Peteraf et al., 2013: 1389) with the differences between the conceptualization of dynamic capabilities in TPS and EM being “starkest and most divergent in high-velocity environments” (Di Stefano et al., 2014: 317). The impact of dynamic capabilities in the form of codified organizational routines on firm performance in high-velocity environments is an area of particularly stark disagreement and divergence between the TPS and EM conceptions of dynamic capabilities.

The seminal paper of TPS originated the construct of dynamic capabilities to answer the question of how firms achieve and maintain competitive advantage “in regimes of rapid change” (TPS: 509). TPS portrayed dynamic capabilities as involving “complex routines” that provide a firm with the “ability to ... address rapidly changing environments” (TPS: 516). TPS argued that this “capacity to reconfigure and transform is itself a learned organizational skill” (TPS: 521) supported by “deep process understanding” and “codification” (TPS: 525). Subsequent research by other authors in the cluster of scholarship related to TPS's framing of dynamic capabilities (cf. Peteraf et al., 2013) has likewise pointed out the performance benefits of dynamic capabilities based on articulated, codified routines (e.g., Zollo and Winter, 2002; Zollo and Singh, 2004; Kale and Singh, 2007). Codification of experience helps firms see through the fog of causal ambiguity that surrounds complex activities by facilitating the identification of the cause-and-effect relationships that govern performance outcomes (Heimeriks et al., 2012; Nelson and Winter, 1982; Zollo and Winter, 2002). Furthermore, codification allows for the externalization of important, often tacit, knowledge and insights, thus improving firms' ability to retain and consistently replicate the lessons learned from past experience (Cowan and Foray, 1997; Nelson and Winter, 1982; Winter, 1987; Zollo and Winter, 2002). Routine codification also contributes to firm performance by instilling discipline, reducing the likelihood of impulsive and biased individual action, and improving the speed, coordination, and accuracy of firm responses in dynamic environments (Nelson and Winter, 1982; Postrel and Rumelt, 1992).

Empirical work associated with TPS's framing of dynamic capabilities as complex, codified routines has provided evidence of a positive relationship between codified dynamic capabilities and firm performance. For example, in the context of acquisitions, Zollo and Singh (2004) find a strong positive relationship between the degree of codification of acquisition experience and acquisition outcomes as knowledge codification gives rise to dynamic capabilities that strongly and positively

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