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Patterns of Dynamic Growth in Medium-Sized Companies: Beyond the Dichotomy of Organic Versus Acquired Growth

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Current research commonly investigates two different growth modes, organic growth and growth by acquisitions. Studies on acquisition-based growth typically draw on cross-sectional quantitative studies of large firms that treat all acquisitions the same. Our study takes a different approach, and explores different growth modes of a smaller sample of medium-sized companies drawing on a longitudinal, qualitative case-study design. This research design allows us to identify eight different growth modes that companies combine in unique ways over time. Thereby, we illustrate that patterns of dynamic growth in medium-sized firms are much more diverse and complex than commonly assumed.

Introduction

Extant research commonly differentiates between two basic modes of firm growth to suggest that companies can grow either organically or by acquiring another company (Lockett et al., 2011; Penrose, 1959). Though many companies might indeed have a preference to either grow organically or through acquisitions, firms engage in various combinations of these two modes as well as hybrid modes, such as the use of purchase contracts or alliances (e.g. Capron and Mitchell, 2010; Moatti, 2009). This variety of growth modes is rarely discussed by academics. For example, a recent comprehensive review of top-journal publications on M&As grouped all relevant articles published into only three categories, (i) antecedents (factors leading firms to engage in M&As), (ii) moderators (as internal and external factors moderating acquisition performance) and (iii) other acquisition outcomes (Haleblian et al., 2009, 471), while the actual *mode* of expansion was not explicitly discussed. One possible reason for this lack of academic attention is that strategic management scholars mainly address the growth mode of mergers and acquisitions (M&As). Here, commonly the focus is on deals made by large companies and their subsequent financial performance (for a review, see Meglio and Risberg, 2011). Business growth is also a common research topic in entrepreneurship studies (for a review, see Davidsson et al., 2010). However, this research tends to focus on explaining differences in growth across firms, and puts insufficient focus on growth modes, i.e. the *how* of growth (McKelvie and Wiklund, 2010).

Thus, this explorative study aims at investigating characteristics and patterns of growth modes in medium-sized firms. We identify multiple growth modes, going beyond the dichotomy of organic versus acquired growth. Our research contributes to the literature on growth in three ways related to shortcomings in extant research:

(1) We identify and characterize six growth modes in addition to the established organic and M&A modes. These six modes have received little or no attention in previous research and allow the analysis of firm growth in a more differentiated manner. They open up for understanding hybrid forms of, and transitions between, organic and M&A growth. However, they also address phenomena such as network-based growth and firm exit that tend to be forgotten when applying the 'organic growth versus M&A' dichotomy.
(2) The typology of eight growth modes that results from our research creates an opportunity to better investigate how a firm changes its growth strategy over time. Literature focusing on only one or two growth modes tends to underestimate the temporal dimension and dynamic changes that occur when a firm shifts between modes. Applying a process approach, we map the dynamic patterns of growth modes, idiosyncratic of each case, and show how the modes can be used to analyze growth strategies longitudinally.
(3) We focus on medium-sized firms, defined as firms with less than 500 employees. As the M&A literature has mainly investigated large companies so far, our findings add knowledge about the process of how firms evolve from SMEs to large organizations. Despite their significant economic relevance, medium-sized firms have not yet received much

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explicit research attention in growth studies (Pasanen, 2007, 320). It cannot be assumed that they are simply 'small large firms' applying the same growth strategies as large firms. They face a number of additional challenges compared to their larger counterparts, such as resource restrictions and limited negotiation power with external stakeholders (see Carrier, 1994). The resource restrictions imply that the medium-sized firms cannot easily 'buy growth' through an acquisition strategy. This makes them good candidates for observing alternative growth modes.

In our empirical study, we explore the dynamic growth processes of eleven medium-sized firms. These companies have a track record of successful growth from small to medium-sized, and are therefore relevant for studying different modes of growth, from pure organic growth to growth by acquisitions and more hybrid growth modes. Before presenting our empirical study, we review relevant research on firm growth building on Edith Penrose's (1959) seminal work and outline our methodological approach.

Literature review

Despite the voluminous literature on business growth, our understanding of the phenomenon of dynamic growth through different modes remains largely limited to the focus on organic versus acquired growth. The strategic management literature has shown substantial interest in mergers and acquisitions as mode of expansion (for recent reviews, see Cartwright and Schoenberg, 2006; Haleblian et al., 2009), while literature on organic growth is much less common and mainly restricted to greenfield entries into international markets (e.g. Barkema and Vermeulen, 1998; Slangen and Hennart, 2007) — probably due to the focus of strategic management on large firms that no longer display much organic growth. For example, Kazanjian et al. (2006) claim that large companies are no longer really growing, and that rather a portion of their earlier reported growth instead was the product of a mix of widespread earnings management and financial engineering, serial acquisitions, and the utilization of accounting and tax manipulations to create specific financial results.

Research on organic growth is more commonly found in entrepreneurship studies, which often attempt to identify internal and/or external factors that can predict future growth (see Davidsson et al., 2010). However, acquisition-based growth is not a common theme in entrepreneurship research (Salvato et al., 2007). Still, the distinction between organic growth and growth by acquisition is important, as the drivers and effects of the two modes of growth have different managerial implications (Levie, 1997; Penrose, 1959).

Organic growth

Organic growth is typically assumed to be the 'normal' growth mode of firms. Indeed, McKelvie and Wiklund (2010, 266) point out that many studies on small-firm growth have inherently assumed growth to be internal (i.e. organic). Organic growth occurs through exploiting existing and new opportunities in old and/or new markets with old and/or new products and services (see Brush et al., 2009). For example, (re-)investments in new production facilities or into the distribution chain of a product can allow the firm to expand by capturing a larger market-share. For achieving organic growth, the internal development of the company is important (Ericson, 2007). This can take place for example through improving its operational processes, by making them more cost-efficient, by establishing a professional sales organization, or by leveraging an established brand image (Achtenhagen et al., 2013; Yip, 1982). In a recent study, Ortiz-de-Urbina-Criado et al. (2014) confirm that firms that expand while maintaining a close relationship with their current business portfolio prefer to grow organically.

Research has examined abundant factors that impact internal growth, such as the role of the entrepreneur or entrepreneurial team, the capability to learn and adapt the organization and its offerings to different demands in the marketplace, or the availability of resources (see the review by Davidsson et al., 2010). For the context of SMEs, it has been pointed out that organic growth is often self-financed, as companies want to ensure that they have the required liquidity for growth (Jessen Holm and Poulfelt, 2002), though it has been argued that beyond a certain pace of growth companies might need to turn to external sources of cash flow such as debt or private equity (Churchill and Mullins, 2001).

Penrose (1959, 44–45) argues that organic growth does not take place automatically and that purposeful planning and the allocation of resources toward expansion are necessary. In order to be able to take advantage of growth opportunities in the market, specialized resources and managerial capacity need to be available to the firm. During the process of expansion, new managerial services need to be created, and a general improvement in skills and efficiency takes place. Over time, managers accumulate experience, demonstrated by their acquired knowledge and enhanced ability to use that knowledge (Penrose, 1959, 53), leading to a versatile resource base in terms of the range of services they can provide. This managerial experience and knowledge would remain unused if the company failed to grow further, thereby providing an inducement for further expansion (Penrose, 1959, 54) — organically or through acquisition. Indeed, Nason and Wiklund (2015) confirm that the Penrosean characteristic of resource versatility is linked to higher levels of growth.

Acquisition-based growth

Penrose (1959) provides different arguments for why companies might choose to acquire existing companies. The costs, as well as managerial and technical difficulties, of entering a new field could be reduced by taking over another company.

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