THE FOUNDATION OF A SUCCESSFUL BUSINESS ENTERPRISE MODEL: DYNAMIC CAPABILITIES ADVISORY PRACTICE
The Dynamic Capabilities perspective goes beyond a financial-statement view of business enterprise assets to emphasize the “soft assets” that management needs to orchestrate both inside and outside the business.

It’s sometimes said that nothing is more practical than a good theory. Top executives seek a deep understanding of enterprise growth and development. Berkeley Research Group has developed a conceptual framework called “dynamic capabilities” to help executives lead organizations in highly competitive global markets exposed to deep uncertainty ("unknown unknowns"). Our Dynamic Capabilities Advisory Practice counsels on changing frames of reference and accepted priorities in order to perform in difficult but attractive marketplaces.

As new bases of competitive advantage have gained in significance, old ways of looking at competition have been supplanted. Michael Porter’s well-known Five Forces framework applied the structure-performance paradigm of industrial economics to strategy and focused on evaluating suppliers, customers, and the threat of new entrants and/or substitute products. This framework is not without insight, but it’s not adequate to reveal the dominant logic of value creation and value capture in industries and markets in which there is uncertainty around customers, competitiveness, technologies, and regulatory policy.

Firms need to take a more comprehensive view of the environment in which they must compete. Such a view must include not only keen insights into customer needs and technological opportunities, but also the local market for skilled workers (since they are not entirely mobile internationally), universities (for access to both highly educated talent and faculty research), financial institutions (especially venture capital), the legal system (especially intellectual property law and employment law), and the domestic political situation. Senior executives and their organizations have to figure out how to “see around corners.”

In order to embrace these new elements of competition, the Dynamic Capabilities Framework was developed. Traditional approaches to strategic management often deflect management’s attention from top priorities. Moreover, traditional approaches focus more on doing things right (optimization, efficiency) than doing the right things (i.e., delivery of what the customer wants by figuring out needs and the next big technological opportunity). Dynamic capabilities offer a comprehensive and multidisciplinary research-based perspective on key strategic challenges. The framework helps organize and harness disciplinary knowledge to apply it to the task of building durable competitive advantage at the enterprise level.

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Dynamic capabilities can be usefully disaggregated into three clusters of activities and adjustments: (1) identification and assessment of an opportunity (sensing); (2) mobilization of resources to address an opportunity and capture value from doing so (seizing); and (3) continued transformation and renewal (shifting). These activities are required if the business enterprise is to sustain itself as markets and technologies change. Performance of these activities draws on all the skills and disciplines used in a business.

Sensing is an inherently entrepreneurial set of capabilities that involves exploring technological opportunities, probing markets, and listening to customers, along with scanning the other elements of the business ecosystem. It requires management to build and “test” hypotheses about market and technological evolution, including the recognition of “latent” demand. The world wasn’t clamoring for a coffeehouse on every corner, but Starbucks, under the guidance of Howard Schultz, recognized and successfully exploited the potential market. As this example implies, sensing requires managerial insight and vision—or an analytical process that can be a proxy for it.

Seizing capabilities include designing business models to satisfy customers while capturing value from them. They also include securing access to capital and the necessary human resources. Employee motivation is vital. Good incentive design is a necessary but not sufficient condition for superior performance in this area. Strong relationships must also be forged externally with suppliers, complementors, and customers.
Companies that successfully build and orchestrate assets within the ecosystem stand to profit handsomely. Apple retained an estimated 40 percent of the gross profits from the entirety of the value chain on its hard drive–based iPods, despite manufacturing no part of the product itself. This is not counting the revenue from licensing makers of iPod accessories or sales from the iTunes Music Store.

Transforming (shifting) capabilities are needed most obviously when radical new opportunities are to be addressed. But they are also needed periodically to soften the rigidities that develop over time from asset accumulation, standard operating procedures, and insider misappropriation of rent streams. A business firm’s assets must also be kept in alignment to achieve the best strategic “fit”: firm with ecosystem, structure with strategy, and assets with each other. Complementarities need to be constantly managed (reconfigured as necessary) to achieve evolutionary fitness and avoid loss of value should market leverage shift to favor external complements.

To summarize, dynamic capabilities are higher-level activities that enable an enterprise to direct its activities towards producing goods and services in high demand or likely to be in high demand soon. They enable the firm to integrate, build, and reconfigure internal and external resources to address and shape rapidly changing business environments.

In essence, strong dynamic capabilities enable an enterprise to profitably orchestrate its competencies and other assets, both within and beyond the organization, reconfiguring them as needed to respond to (or bring about) changes in the market and in the business environment more generally. Strong dynamic capabilities will enable the organization (and especially its top management) to develop conjectures about the evolution of markets and technologies, validate them, and realign assets and competences to meet new requirements ahead of the competition. The dynamic capabilities methodologies are at odds with cultural norms that confuse risk with uncertainty, that cherish the status quo, and that fail to empower entrepreneurs and change agents.

Whereas strong ordinary capabilities are built on best practices, strong dynamic capabilities are founded on signature practices and employ differentiated business models. Signature practices arise from a company’s heritage and business models and methodologies that allow companies to look out ahead and discover and act upon (seize) emerging futures.

Dynamic capabilities differ from ordinary capabilities or best practices. Individuals and parts of an organization may possess skills, resources, processes, or practices that make them successful in the jobs they do (“ordinary” capabilities). Too much advisory work and internal focus is on doing a job better, rather than on doing the job right. The payoff for the latter is often a multiple of the former. Effective and impactful strategic management, however, requires that leaders both (1) identify all the “ordinary” or “necessary” capabilities relevant for strategy execution, which are often spread throughout disparate parts of their organization or may even reside outside of it; and (2) build, improve, and manage a cluster of strategically relevant activity required to solve problems, mitigate risks, capture market share, or serve strategic purpose.
The essence of dynamic capabilities is that they cannot generally be bought (apart from acquiring the entire organization); they must be built. They are often highly context specific. BRG professionals can advise on applying the framework (and associated methodologies) to particular commercial circumstances. Apple CEO Tim Cook said it well:

Apple remains ahead of its rivals in the ability to innovate and "create magic" despite tougher competition in key sectors like smartphones and tablets... Apple still has strong growth opportunities because of its ability to work simultaneously on hardware, software and services... Apple has the ability to innovate in all three of these spheres and create magic... This isn't something you can just write a check for. This is something you build over decades.

Dynamic capabilities, although essential for creating sustainable competitive advantage, must still be used in aid of, and in conjunction with, a good strategy in order to be effective. Strategy, capabilities, and the business environment complement each other and co-evolve. Strong dynamic capabilities will become worthless if they are tied to a poor or badly misjudged strategy, and vice versa. BRG professionals advise clients on avoiding these pitfalls.

BRG Chairman David Teece and two of his doctoral students originated the theory of dynamic capabilities 20 years ago. There are now more than 40,000 Google cites to Professor Teece’s work on this subject.

ABOUT BRG

Berkeley Research Group, LLC is a leading global strategic advisory and expert consulting firm that provides independent advice, data analytics, authoritative studies, expert testimony, investigations, and regulatory and dispute consulting to Fortune 500 corporations, financial institutions, government agencies, major law firms, and regulatory bodies around the world.

BRG experts and consultants combine intellectual rigor with practical, real-world experience and an in-depth understanding of industries and markets. Their expertise spans economics and finance, data analytics and statistics, and public policy in many of the major sectors of our economy, including healthcare, banking, information technology, energy, construction, and real estate.

BRG is headquartered in Emeryville, California, with offices across the United States and in Australia, Canada, Hong Kong, Latin America and the United Kingdom.

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