

Investigating the influence of static capabilities on firm performance of the grain milling subsector in Tanzania

Keywords: **Capabilities, Performance**

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Introduction

Firm performance in the grain milling is critical for the growth of, not just businesses, but also the economy. Firm performance is attributed to a firm's ability to create sustainable competitive advantage over its competitors (Porter, 1985, 1996). Ever since the publication of Barnard's *The functions of the Executive* (1938) strategy scholars (Barnard, 1938; Barney, 1991; Grant, 1991; Helfat et al., 2007; Kor & Mahoney, 2004; Nath, Nachiappan, & Ramanathan, 2010; Porter, 1996; Teece, Pisano, & Shuen, 2007, 1997; Yu, Ramanathan, & Nath, 2014; Zott, 2003) have been concerned with what accounts for firm performance. The dependence of a firm's performance on its capabilities has been widely acknowledged (Day, 1994; Nath et al., 2010; Song, Benedetto, & Nason, 2007; Song, Droge, Hanvanich, & Calantone, 2005; Yu et al., 2014). Nonetheless, the kinds of capabilities leading to firm performance in developing countries are still unclear when compared to developed economies. In the developing countries, institutions play a great role in influencing firm performance, and the business environment is subject to highly imperfect markets, while in the developed economies market forces determine prices and therefore firm performance (Meyer & Peng, 2005; Peng, Wang, & Jiang, 2008).

Two schools of thought exist in the literature on what primarily determines firm performance. Some claim firm performance is primary determined by the internal factors of the firm ((Barney, 1991; Grant, 1991; Teece et al., 1997) while others (Chandler, 1962; Porter, 1985, 1996) claim that it the external part of the firm. However, the current management thinking of most strategy scholars is on the internality part of the firm being the primary determinant of firm performance. Resource Based View (RBV) is the main theoretical foundation for this study due to its significant contribution it makes. It theorizes that resources and capabilities explain the variations in success among firms competing within the same industry (Helfat & Peteraf, 2003).

It is argued that possession of superior resources cannot achieve competitive advantage but how a firm deploys its scarce resources to create immobile and inimitable capabilities (Barney, 1991; Grant, 1991). The latest scholars using this theory categorize capabilities into two that is functional/static and dynamic capabilities (Protogerou, Caloghirou, & Lioukas, 2011; Teece et al., 2007). Functional capabilities are concerned with day to day activities of the firm while dynamic capabilities with change in the business ecosystem. The extant literature on RBV has highly focused in the developed economies while relatively less is known in the developing context about the nature of firm's capabilities influencing performance (Makkonen, Pohjola, Olkkonen, & Koponen, 2014).

Dynamic capabilities are concerned with sustaining functional capabilities during change in business environment (Teece et al., 1997; Teece, 2007). Dynamic capabilities particularly the learning, collaboration and strategic response are adopted in this study because of two major reasons. Competition in the grain milling subsector is not intense when compared to the developed countries context but institutions play a vital role. The role of dynamic capabilities is less known in the developing context with more or less stable market environment as its application has been in volatile markets. Dynamic capabilities are highly tested in high levels of environmental dynamism not well tested in other environmental conditions (Protogerou et al., 2011) The business ecosystem in the grain milling undergoes change, it is important to reveal the role of dynamic capabilities as advocated by (Teece et al., 1997; Teece, 2007). They enable organizations to integrate, build and reconfigure their resources and capabilities (Eisenhardt & Martin, 2000; Helfat & Peteraf, 2003). They would reconfigure capabilities to face challenges in the changing business environment of the grain milling sub-sector (Weerawardena & Mavondo, 2011). Secondly as part of the contribution of this study will be the operationalization of dynamic capabilities constructs which have not reached a consensus.

The question of why do firms in the Tanzanian grain milling subsector perform differently has been the major driver for this study. Tanzania grain milling sub-sector operates in a business environment that has moved from centrally planned towards a market economy. Structural

changes continue to be observed since 1980s to-date. Business environment in which agribusiness firms operate is claimed to be overregulated (compliance), faced with limited access to finance, poor infrastructure, limited lobbying and advocacy activities (Charles, 2014). Firms under grain milling have to abide to all regulations aimed at food hygiene and security. Despite the changing business environment in the grain milling sub-sector some firms have emerged to be successful as clearly stated by Donley, (2012). These firms have managed to cross-borders (exporting and setting FDI's in the neighboring countries), have survived in the market for some years, and have high visibility in the market (market share), employing more people and using the latest technology. Donley, (2012) reports the expansion of the grain milling in Tanzania. He mentions companies having capacity to cross borders to Rwanda and Mozambique through exportation and some through FDI's. These firms identified to be successful were once micro enterprise or they had a humble beginning (Sutton & Olomi, 2012). This raises an interesting observation that there is undisclosed secret about success in the Tanzania grain milling industry. This study adopts the RBV to establish the influence of functional capabilities on firm performance and the mediating effect of the dynamic capabilities.

Theoretical and Hypotheses Foundations

RBV and Capabilities

This study adopts Teece et al., (1997)'s RBV conceptualization that organizational capabilities are a source for sustained competitive advantage. Capabilities are considered in this study rather than resources as they can best explain performance differences in the grain milling sub-sector. This is after Penrose's (1959) contribution in Kor & Mahoney, (2004) where she argues that resources provide productive services that is what makes a difference among firms. This is further supported by Grant, (1991, p. 118)'s contribution that resources are "inputs into production". Hence, this study agrees that in the grain milling context resources (plant, machinery, and capital) are not productive on their own; it is the productive service (capabilities) that makes difference among firms. Firms in the grain milling subsector owning assets, human power could do not be enough to create productivity differences. Capabilities bind resources together and allow then to create competitive advantage (Day, 1994). The difference in

capabilities among grain milling firms could be attributed in efficiency of the firm's ability to utilize its resources into valuable and non-imitable as inspired by Song et al., (2007). Thus, from Helfat & Peteraf, (2003) and Song et al., (2007)'s contributions possession of superior resources in the grain milling subsector could not achieve competitive advantage for a firm but how a firm deploys its scarce resources put its capabilities to best use, invest and complement its existing capabilities infrastructure can bring "immobility and inimitability" to its resource-capability framework.

A controversial still exists on the use of the terms resources and capabilities as some scholars are inspired by Barney, (1991)'s contribution who includes resources to be all assets, capabilities, organizational processes, firm attributes, information, knowledge controlled by a firm. They use the term resources instead of capabilities. However, this study agrees the contribution of resources on capabilities as argued earlier. Capabilities on the other hand have received great attention from different strategy scholars (Amit & Schoemaker, 1993; Day, 1994; Helfat & Peteraf, 2003; Nath et al., 2010; Teece et al., 1997; Teece, 2007; Yu et al., 2014). A consensus seems to exist where most of the scholars trace their capabilities definition in Day, (1994). Capabilities are defined as complex bundles of skills and accumulated knowledge that enable firms to coordinate activities and make use of their assets (Nath et al., 2010; Yu et al., 2014). Capabilities can't be traded in the market place; they are embedded in the organization routines and processes. Capabilities could be either static or dynamic (Protogerou et al., 2011). Capabilities are traced in organizational processes.

Evolution of Dynamic Capabilities

Peng *et al.*, (2008), Oliver (1997) and Peng (2003) agree that markets for food processing products in developing economies like Tanzania are still at infant stage thus the level of market dynamism is quite low. The market volatility being low doesn't undermine the role of dynamic capabilities in the turbulent institutions. It is not easy to duplicate what is observed in the developed economies to the developing economies (Peng and Meyer, 2005). Teece *et al.*, (2007) identifies that sustainable competitive advantage is a function of firm's processes, positions and paths. Dynamic capabilities are often characterised as unique and idiosyncratic processes that

emerge from path-dependent histories of individual firms (Teece *et al.*, 1997). They are identified as complicated routines comprising a variety of processes (Protegerou *et al.*, 2011). Teece *et al.*, (1997) argue that the competitive advantage of firms lies within their organizational and managerial processes, shaped by specific positions and paths available to them. The central question coming to mind is how do dynamic capabilities evolve in the emerging economies as they are context dependent? Could the processes, positions and paths be the same as in developed countries? The business environment in Tanzania could suggest different critical moments that might have shaped the dynamic capabilities. The available literature (Bagachwa, 1992 and Donkey, 2012) on grain milling has really addressed this. Thus this study will focus on exploring the processes, positions and critical moments that have shaped the dynamic capabilities in the grain milling context.

Marketing Capabilities and Firm Performance

Marketing capability involves integration of all marketing related activities of a firm using superior market knowledge from customers and competitions (Day, 1994; Dutta, Narasimhan, & Rajiv, 1999; Nath *et al.*, 2010; Song *et al.*, 2007, 2005). They include knowledge of the competition and of customers, skills in segmenting and targeting markets, advertising and pricing, integrating marketing activity (Nath *et al.*, 2010). They are developed by combining employees' knowledge and skills with the available resources which once built may be hard to imitate (Yu *et al.*, 2014). It is argued that a firm with marketing capabilities creates superiority among other firms; as it best identifies customer needs and wants leading to best segmentation, targeting and positioning strategies (Dutta *et al.*, 1999). Best strategies lead to high margins which infer high financial performance.

Empirical evidence reveals that their impact towards firm performance has led to different results. Nath *et al.*, (2010) in their study of 102 UK logistics companies found significant positive relationship between marketing capabilities and business performance. In a study of 72 semiconductors manufacturing firms by Dutta *et al.*, (1999) it is revealed that marketing capabilities have significant impact of firm performance. Other scholar who revealed the same include (Vorhies, Douglas W and Morgan, 2005),(Song *et al.*, 2005),(Song *et al.*, 2007).

However, (Yu et al., 2014) reveals that marketing capabilities have no relationship to financial performance rather when mediated by the operations capabilities. This study takes the marketing capabilities on board as grain milling firms produce varieties of brands for different customer wants. Hence, it would be important to reveal what extent the possessed marketing capabilities contribute to the observed financial performance. The marketing capabilities to be examined include ability to have branded products, strong sales team, installed customer base. These are inspired from Day, (1994 and Nath et al., (2010)h From the above arguments it is hypothesized that;

H1: Marketing capabilities have positive influence on firm performance

H1a) Branded products have positive influence on firm performance

H1b) Strong sales team has positive influence on firm performance

H1c) Installed customer base have positive influence on firm performance

Manufacturing Capabilities and firm performance

For long manufacturing capabilities are known to be strongly associated with competitive success on basis of time, flexibility, low cost and product quality (Terjesen, Patel, & Covin, 2011). It is argued that a firm to achieve production related goals manufacturing capabilities are core proficiencies in manufacturing industry(Capon, Farley, & Hoenig, 1990). These could be consistent product quality (conforming to specifications), cost control, time/ throughput speed, volume and product flexibility and delivery dependability (Hanna, 2007; Sheather, 2002; Terjesen et al., 2011). The empirical literature exemplifies that superior marketing capabilities lead to competitive advantage and high performance. Terjesen et al., (2011) based on their study on 106 high technology manufacturing firms in UK examine the relationship between manufacturing capabilities associated to low cost production and product quality and venture performance. The results revealed positive relationship between the two. The extant literature on firm capabilities has focused on marketing and operational capabilities (Nath et al., 2010; Song et al., 2005; Yu et al., 2014) and some on marketing and technological capabilities (Protogerou et al., 2011). Limited studies linking manufacturing capabilities to firm performance -(Terjesen et

al., 2011). Thus this study makes a contribution by examining the contribution of manufacturing capabilities in relation to firm performance. This study accommodates manufacturing capabilities (particularly those leading to low production cost and product quality) as previously put that manufacturing entities have to have superiority in manufacturing capabilities to leap production oriented goals. It is thus hypothesized that

H2: Manufacturing capabilities have positive influence on firm performance

H2 a) There is a positive relationship between low operating costs and firm performance

H2 b) There is a positive relationship between high quality products and firm performance

Dynamic Capabilities and their mediation role on firm performance

Teece is the pioneer of this concept in his 1997 and 2007 contributions (Teece et al., 2007, 1997). The concept has received more attention from strategy scholars (Helfat & Peteraf, 2003; Li & Liu, 2014; Makkonen et al., 2014; Ortega, 2010; Protogerou et al., 2011; Wilden, Gudergan, Nielsen, & Lings, 2013). The concept has become the academic and managerial strategic thinking today (Lin & Wu, 2014). Dynamic Capabilities' conceptualization, context, measurement and its relationship to performance has not reached a consensus (Weerawardena & Mavondo, 2011). Dynamic capabilities as a firm's ability to integrate, learn and reconfigure internal and external resources (Teece et al., 1997), to generate and modify (Zollo & Winter, 2002), to integrate, reconfigure, gain and release, and match environmental change (Eisenhardt & Martin, 2000). They are adopted in this study due to their role on functional capabilities in enhancing firm performance.

This study in connection with grain milling context adopts Teece, (2007)'s modified definitions of ability to sense and shape opportunities and threats, seize opportunities and enhance opportunities through reconfiguring both intangible and tangible assets. It is a fact that grain milling context has some institutional challenges which may lead to eroding of functional capabilities. Firm's with dynamic capabilities in the grain milling subsector are in position to

strengthen their functional capabilities identify and seize new opportunities in the business ecosystems. For instance new areas of diversification created by changes in the regulations, access to funds due to changes in financial regulations, see opportunities in infrastructure development. Hence, their role doesn't involve a production or provision of a marketable service (Helfat & Peteraf, 2003). They sustain firm's evolutionary fitness (Teece, 2007). Dynamic capabilities are traced in different organization processes. Different organizational processes are brought up integration, learning, reconfiguration (Teece et al., 1997); coordination, learning and strategic response (Helfat & Peteraf, 2003; Protogerou et al., 2011).

Considering the processes identified above, this study identifies an overlap in these processes. This study will focus on learning, collaboration and strategic response. This is the inspiration from Protogerou et al., (2011) and Teece, (2007). In grain milling context collaboration refers to the firm ability to create alliances with other stakeholders in the business ecosystems. These could be suppliers of different inputs to the production process, collaborate with financial institutions, research institutions, policy makers, develop lobbying strategies. This is an important capability to deal with the changing business environment in the grain milling. With learning capabilities firms in the grain milling would achieve strategic renewal (Protogerou et al., 2011) , absorb external information and resources (Amit & Schoemaker, 1993), and working in teams. Firms having such capabilities a firm is able furnish its marketing and manufacturing capabilities thus create competitive advantage. Strategic response makes the firms have ability to respond to new opportunities in the business ecosystem such diversification, new customer needs and seize such opportunities.

Dynamic relationship to firm performance has been vague. However, of late a consensus sounds to be reached where scholars agree that dynamic capabilities don't have direct influence on firm performance (Eisenhardt & Martin, 2000; Helfat & Peteraf, 2003;; Winter, 2003). This study is in consensus with Helfat & Peteraf, (2003)that dynamic capabilities affect the output of the firm in which they reside but indirectly through the impact on static capabilities. In the grain milling context the basic functions are identified to marketing and manufacturing and dynamic

capabilities is there to sustain them during the changes in business environment. Empirical evidence continue to reveal that their impact on firm performance is indirect (Li & Liu, 2014; Lin & Wu, 2014; Makkonen et al., 2014; Protogerou et al., 2011; Wilden et al., 2013). Hence this study will establish their influence on static capabilities on performance as reflected in the conceptual model. It is hypothesized thus that

H3: Dynamic capabilities have positive influence on firm performance

H3a) Collaboration capability has positive influence on firm performance

H3b) Learning capability has positive influence on firm performance

H3c) Strategic response capability has positive influence on firm performance

Control variables

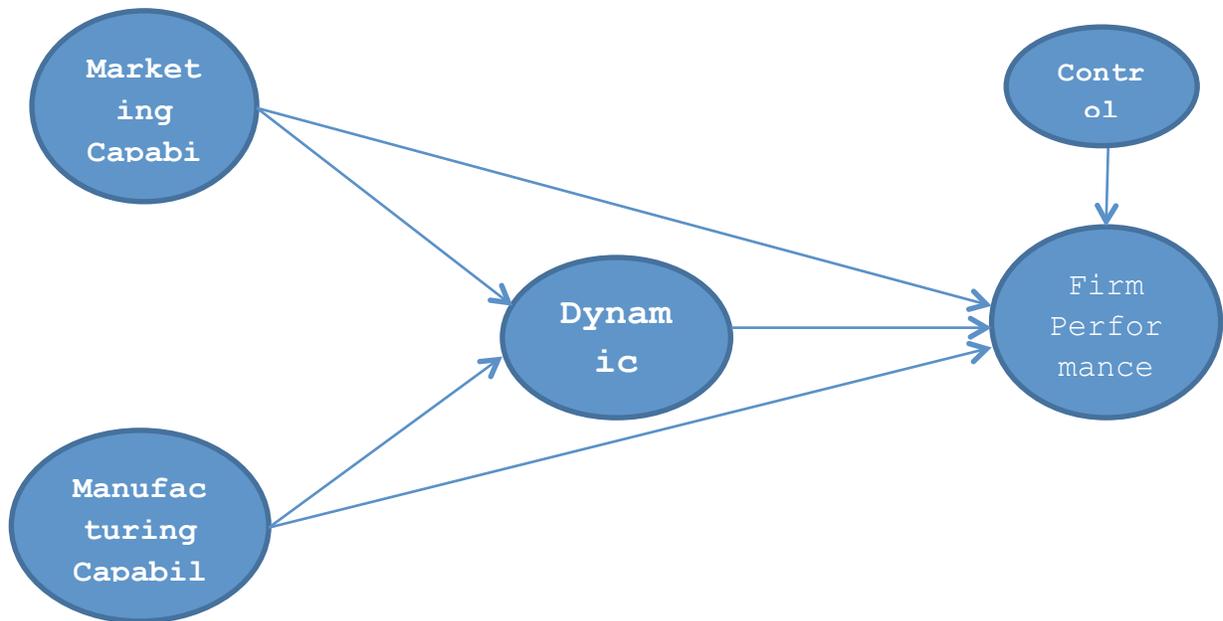
Firm size and firm age are the control variables for this study. instance marketing capabilities impact differs with firm size large are in a position to invest more in in customer loyalty Big firms owing huge resources may create a best position in the market and scale economies (Ortega, 2010). Manufacturing capabilities are very rare among young and small firms (Fan, 2009). Young firms are resource constrained thus accessing expensive process technologies and other tangible assets on which manufacturing capabilities are built (Terjesen et al., 2011). Moreover, manufacturing capabilities are based on complex resource interactions and organization routines that can take years to develop (Cleveland, Schroeder, & Anderson, 1989).

Firm Performance

This measure has been pronounced to be one of the measure that is complex and with multi-dimensional constructs. Various measures have been identified on how firm performance is gauged. There are objective and subjective measures (Li & Liu, 2012). Objective measures include the popular proxies to ROA and Tobin's Q while subjective measures include self-reporting of the managers on performance indicators. This study will use subjective measures.

Subjective measures are correlated to objective measures as verified by Protogerou et al., (2011). In the grain milling context objective might be misleading due to different accounting principles, tax purposes, poor record keeping, difficult to access or n database or sometimes firms may not be willing to provide this financial data. Thus subjective assessment/measures will be used to measure firm's performance. This study borrows from Ortega (2011) and Gupta and Goundarajan (1984) by weighing the satisfaction assessment and importance level by the CEO using a Likert scale on the extreme side of satisfaction with firm performance. with 1 not satisfactory to 5 outstanding. The measures include both financial and market indicators

Framework to measure static capabilities-firm performance mediated by dynamic Capabilities



Research Methodology

Philosophy and Approach

Critical realism philosophy guides the entire study as it provides an alternative to several philosophical and methodological positions which have been found wanting (Sayer 2009). The

nature of the phenomenon in question of studying of intangible firm's resources and examining causation among variables requires this philosophy. In connection to the philosophy this study uses a triangulation approach in responding to the research questions raised. This is adopted to increase the understanding of capabilities thus providing more insights into practice as advocated earlier by Protegerou *et al.*, (2011). Moreover, lack of consensus in the definition and its complex nature, the dynamic capabilities research area requires rich and diverse research methods (both qualitative and quantitative) for empirical testing (Helfat *et al.*, (2007), Ambrosini and Bowman (2009). Janssen *et al.*, (2012) argue that a study on capabilities requires a rigorous formal testing that involves both exploratory case studies and large-scale surveys. It is under this justification that this study will use survey strategy and case-study strategy sequentially.

Area of Study

The study will focus on the four regions that have high concentration of grain milling firms according to NBS (2010 data; notably: Dar es Salaam, Mwanza, Arusha, Morogoro and Singida.

Sampling Procedures

As per Sekaran (2003) definition, a population for this study is the total number of firms operating under the grain milling subsector. For both strategies (survey and case study) the unit of analysis is the firm's organization and managerial processes. The study will target respondents who are top management middle or senior managers working with the enterprise/firm for at least one year to ensure full understanding of the firm believed to be key informants and knowledgeable about firm's capabilities (Protegeou *et al.*, 2011). A sample will be drawn from a database assembled from National Bureau of Statics (2010). This database has information on firm size, physical address, phone numbers and year of registration. The NBS (2010) database has a total of 1292 firms located in different regions of Tanzania. Thus using Krejcie and Morgan (1970) 291 firms will be selected in the identified regions above. This is adopted as the parameters for calculating the sample size are not easily attainable adopted from (Sekaran, 2003) Stratified sampling strategy will be used to extract these firms. Protegeou *et al.*, (2011) and Janssen *et al.*; (2012) arguments, a selection of firms will base on firms with at least 10 employees both permanent and casual to ensure minimum operating and organizing structures.

For the case study strategy, purposeful sampling will be adopted as it is at learning and understanding the organization and managerial processes as advocated by Makonnel *et al.*; (2013) and Eisenhardt and Graebner, (2007). The purpose is to sample cases that best enhances the research phenomenon in question. It is three cases as advocated by Sayer (2009) and Makonnel *et al.*; (2013) that the approach is a bit time consuming so that it is optimal to deal with a small number of cases and for data manageability.

Data Collection Methods

The use of survey strategy is not new under the field of strategic management research as it has been in use for a couple of years past (Mason 1939, Dain 1956, Bain 1968, Hoslusson et 1999). It is used in this study to validate the scientific hypothesis as advocated by Hoskisson et al., (1999) and Schendaeln& Hatten (1972). Moreover, this approach is adopted in this study to supplement case study strategy as argued by Porter (1981) in Hoskisson et al (1999). This strategy will as well operationalise, and refine the dynamic capabilities (Farjon, 1994, Li and Liu, 2012, Jenssen *et al.*; 2012, Makonnel *et al.*; 2013). A questionnaire will be developed from a wide review of the literature as advocated by Ortega, (2010). However, a pre-test will be conducted to refine the measures expected to be used. A case study strategy is adopted to validate the findings obtained in the survey stage as advocated by Jenssen *et al.*; (2012). This will lock the findings obtained in the survey to be context specific. The essence of using a case study is basically providing insights into the unknown inert capabilities in the grain milling firms as it is argued by Ghauri (2009) that a case study is useful when the area of research is less known. It is further credited for being strong strategy in investigating processes in real contexts (Makonnel *et al.*; 2013). Under this strategy will involve in-depth interview and documentary review.

Types of Data/Information

From the questionnaire apart from the basic data about the firm and entrepreneur data related to the nature of capabilities present and their influence towards performance will be collected. From the case study, through in-depth interview information related to general explanations of the sources and origins of success such as historic processes, critical moments, development pathways to the current situation of the firm, multiple decisions on different managerial issues,

important/ unimportant, novel/ routine decisions in one organization will be gathered. Documentary review (financial statements, strategic plans, business plans) will be done to supplement the interviews as guided by Glueck and Wills, 1979 and Makonnel *et al.*; (2013).

Measures

Mediating variables

The mediating variables under this study include entrepreneur resources (age of the entrepreneur, gender, experience and education level, founder of the firm and formation in management) and firm resources (firm size, ownership and age). Firm size (number of employees as per Tanzania SMEs policy) and firm age (categorization provided by Li and Liu (2012)) will be used-five groups 0-5 yrs, 6-10 years, 11-20 years, 20-25 years and over 25 years).

Firm Performance

This measure has been pronounced to be one of the measure that is complex and with multi-dimensional constructs. Various measures have been identified on how firm performance is measured. There are objective and subjective measures (Li and Liu,2012). Objective measures include the popular proxies to ROA and Tobin's Q while subjective measures include self-reporting of the managers on performance indicators. This study will use subjective measures. Subjective measures are correlated to objective measures as verified by Protegeroue *et al.*, (2011). In the grain milling context objective might be misleading due to different accounting principles, tax purposes, poor record keeping, difficult to access or n database or sometimes firms may not be willing to provide this financial data. Thus subjective assessment/measures will be used to measure firm's performance. This study borrows from Ortega (2011) and Gupta and Goundarajan (1984) by weighing the satisfaction assessment and importance level by the CEO using a Likert scale on the extreme side of satisfaction with firm performance. with 1 not satisfactory to 5 outstanding. The measures include both financial and market indicators.

Firm Capabilities

The two static capabilities (marketing and technical capabilities) have accredited to have substantial contribution towards firm performance as suggested by Jenssen *et al.*; (2012) thus

this study will as well adopted them. On the other hand dynamic capabilities despite lack of consensus the following are taken on board notably; coordination, learning innovation,

Data Analysis

Under the survey strategy smart partial least square structural equation modelling will used as it is efficient in taking care of the latent variables in a model, quality measures, role of the mediating variables as advocated by Hair, Hurt, Ringle, & Marko, (2014). In establishing the relationship between latent variables (static and dynamic) and performance higher order models will be used. However, analysing qualitative case-studies is claimed to be one of the challenging task as the method of analysis is not well formulated (Ghauri, 2009). However, analysis of the data will start immediately after the collection process as it is claimed to be the best strategy (Miles and Huberman, 1994). This implies when data from one case is collected analysis starts immediately doesn't have to wait for the collection of another case as it will be immediately transcribed into a written form. This will assist in rectifying areas in data collection process and avoidance of high information overload. In analysing data collected a model suggested by Ghauri (2009 p.118) has been adopted that identifying chronologies, coding, clustering, matrices, decision tree modelling and pattern matching.

Reliability and Validity

Both Cronbach alpha and composite reliability will be used to establish the level of internal consistency of all the constructs whereby a value above 0.708 will indicate high level of internal consistency. Moreover, face to face administration of the structured questionnaires will ensure accuracy of the data. Thus, before embarking on a survey top managers of different firms and supervisors will be consulted in the process of questionnaire development and design phase for pre-testing as advocated by Protegeou *et al.*, (2011). This will improve content validity. Most of the scales expected to be used are borrowed from various studies by Li and Liu (2012), Protegerou *et al.*, (2011) and Ortega (2011) as validated scales. Moreover, convergent validity will be established to show indicators that are above 0.5 and discriminant validity will be established to see whether the construct measurements are unrelated. In the application of the case-study the issue is the authenticity of the data rather than the reliability. This is well argued

by Yin (2009) on how generalization under the case study strategy is not that much desired rather authenticity.

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