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# Development of Different SMEs Growing Stages using Configurational Theory

**Deniss Sceulovs [1*], Vladimir Shatrevich [2] and Elina Gaile-Sarkane [3]**

[1,2,3] Riga Technical University, 6 Kalnciema Str., LV-1048, Riga, Latvia

## ABSTRACT

**Objective –** The purpose of article is to study the factors that positively influenced the development of enterprises, named as "success factors", creating model of success factors that affect entrepreneurial process. The article investigates configuration during the process of company growth.

**Methodology/Technique –** The theoretical and methodological groundwork of the study is formed of scientific articles, monographs, regulatory enactments and researches, conference materials, internet resources, expert opinions published in Latvia and abroad. In the research generally accepted qualitative and quantitative data analysis methods of the economic science were employed, among them, statistical data processing, data grouping, and inductive-deductive data analysis methods. The scientific study employs surveying, observation study method, as well as comparative and analytical methods, which are used by the authors to compare and analyse facts and assess solutions to specific issues.

**Findings –** As start-ups grow, there are several factors that determine their successful operations. The empirical pre-research survey conducted by the authors allowed identifying several factors that affect a company's long term development. According to analysis, the factors were divided into four groups. The factors determined by the authors of the article are mutually related and considered as a whole system according to configurational approach.

**Novelty –** The authors point out that the factors described and grouped in this article will serve as the ground for further studies, during which the authors will perform factor classification.

**Type of Paper:** Review

***Keywords***: SMEs, Success Factors, Development of a Company, Growth, Stakeholders Values, Configuration.
**JEL Classification:** M10, M19, M20.

## 1. Introduction

The formation of new companies is considered to be one of the most important sources of new workplaces creation. In US new companies generate half of all new workplaces in the country (European Commission, 2012). For instance, US startups account for a half of all new jobs (Reynolds and Curtin, 2011). US companies that survive on average by the year seven increase the number of employees by 60 %, whereas companies that survive in Europe increase the number of employees by about 10 %–20 % (Global Entrepreneurship Monitor, 2013). The foundation of Latvian and EU economy is formed with micro, small, and medium enterprises (SME). They

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* Corresponding author:
E-mail: deniss.sceulovs@rtu.lv
Affiliation: Riga Technical University, Latvia

account for 98.8 % of all companies (European Commission, 2012). SME face various difficulties in starting entrepreneurship and managing to keep it alive. The biggest challenge for SMEs is the limited availability of various resources (financial, human resources, etc.). Furthermore, if compared to the bigger companies, a smaller number of European SMEs achieve innovations. The situation has been deteriorated by structural hardships, such as, lack of managerial and technical skills, and at the state level the labor market is still inflexible. These and other factors adversely affect sustainability of companies. At the same time, there is a range of success factors, which contribute to the growth of companies and successful entrepreneurship. It is also questioned by the authors of the paper why many Latvian startups are short-lived? Why there are less success stories in Latvia compared to other countries - for example Estonia, Scandinavia and United States (in proportion to the size of the economy or population). Several possible causes are noted: lack of access to finance for start-up business, quality of education programs, lack of access to infrastructure and other factors. The authors justify this choice with the fact that the data about companies which manage to successfully develop is available less frequently than data about "failure factors", i.e. about companies which have ceased to exist. The determination and analysis of such success factors
will help the developers and implementers of various state education and lifelong learning programs in their work, as well as assist startups and existing companies to analyse and pinpoint their strengths.

The same applies to other non-entrepreneurship spheres (such as, non-governmental organisations, etc.), where timely attention must be paid to promoting development. Global Entrepreneurship Monitor (GEM) 2012/2013 indicates that, while Latvia has achieved a high early stage entrepreneurship rate, there is still potential for improvement. A gap exists between entrepreneurial intentions and actual participation in entrepreneurial activity.

## 2. Organisation development and configurational theory

In addressing this SMEs problematic scientists posit that the strategic fit between strategy and structure determines business performance. For example, configuration theory's key assumption is that each business strategy has a unique set of ideal organizational structures, and therefore, a better fit between the two yields higher performance (Hult et al., 2006). The importance of fit among a firm's strategic orientation has already been emphasized (Bhuian et al., 2005; Ruokonen and Saarenketo, 2009) and organizational configurations are well suited to explain performance (Harms et al., 2007; Ketchen et al., 1997), beyond parallel or contingency approaches (Dess and Lumpkin, 2005).

The theoretical framework postulates that strategic fit, match or congruence between a company's strategy and environmental or organizational contingencies leads to enhanced business performance (Zajac et al., 2000). The premise of a configurational perspective (Wiklund and Shepheard, 2005) is that in organizations certain strategic, structural, process or environmental factors build clusters in specific configurations (Meyer et al., 1993). Superior company growth is then the result of a consistency among these factors, which forms a competitive advantage (Miller, 1996). Companies that are able to align specific factors will outperform others, that are unable to build such alignments are disadvantaged (Wiklund and Shepheard, 2005). Companies' strategic orientations are capabilities that are potentially complementary and may collectively lead to competitive advantages (Hult and Ketchen, 2001). Complementary patterns emerge from unique combinations of capabilities that are hard to imitate and generate synergies leading to superior firm growth. Companies that are able to align different strategic orientations in a superior configuration over their competitors achieve sustainable competitive advantages enhancing growth-based performance (Hult et al., 2004). Under a configurational approach, performance is the result of internal coherence of organizational and strategic factors among themselves and with the specific context of the organization (Doty et al., 1993; Meyer et al., 1993; Miller, 1986, 1996). Such approach allows identification of distinct configurations or archetypes resulting from specific combinations of multiple dimensions, wherein strategies are identified as multidimensional archetypes (Cerrato et al., 2015).

However, strategic fit or configuration model measurement accepted as a challenging task. Even though strategic orientations have attracted vast research attention over the past decades, the field is far from settled (Deutscher et al., 2016). The strategic fit has been defined as an internal consistency or alignment (Ensign, 2001),

but has been difficult to conceptualise and measure empirically (Delery and Doty, 1996: p. 808) note that configurational approach is more complex and consists of researchers who seek to '... identify configurations, or unique patterns of factors, that are posited to be maximally effective'. This category of researchers is also said to approach their subject from a more theoretical perspective and many of the phenomena they identify may not necessarily be empirically observable (Doty and Glick, 1994). Organizational configurations are "any multidimensional constellation of conceptually distinct characteristics that commonly occur together" (Meyer et al., 1993: p. 1175). Capabilities, structures and processes need to be managed coherently within organizations, in order for a configuration to be effective (Hill and Birkinshaw, 2008; Meyer et al., 1993; Miller, 1996). From such configurational approach a company' results depend on both the consistency between structural and strategic factors and the congruence of those factors with the context (Wiklund and Shepherd, 2003). Hence, in order to achieve high performance company must be structured following internally consistent configurations, which at the same time have to be consistent with the environment (Ketchen et al., 1993; Short et al., 2008)

Scientific research organizational configurations (Fiss, 2005; Woodside, 2013) or cases as combinations of attributes (i.e., as different configurations) allows 'an assessment how different causes affect relevant outcomes' (Fiss, 2005), but these approaches are 'more closely aligned with the theoretical thrust of configurational theory, which stresses the existence of effects that are not simply linear, additive, and unifinal' (Fiss, 2005: p. 1194).

Recent works on configurational approach, by providing a more detailed understanding of how strategic orientations jointly affect the performance (Deutscher et al., 2016; Garcia-Villaverde et al., 2013) confirm that configurational models are sophisticated. Contrary to prior research focusing on the isolated effects of EO on different dimensions of company performance (for comprehensive overviews, see (Rauch and Wiklund, 2009; Wales et al., 2013), the recent findings (Deutscher et al., 2016) suggest that companies are able to achieve higher performance levels if all strategic orientations (EO MO and LO) are strong or company has highest levels of MO. However, the 'more is better' inferences resulting from such approaches may not lend feasible strategy implications for resource-constrained firms (Cadogan, 2012). As a conclusion, the authors conclude that modern configurational models - (entrepreneurial orientation (EO), market orientation (MO), and learning orientation (LO) - are hardly usable for SMEs (startups e.g.).

## 3. Configurational theory for start-ups

Despite these methodological and conceptual challenges, strategic fit has been an important building block in the development of strategic management theory (Drazin et al., 1985; Venkatraman and Camillus, 1984). As Rich (Rich, 1992 p. 758) notes, 'classifying organizations into types presents an alternative to the idea that organizations are either all alike or are all individually unique'. Configurational theorists of strategy, therefore, suggest that it is reasonable to believe that every business can be managed by a limited number of generic strategies (Miller, 1996). 'It would be interesting to investigate… why firms tend to adopt a specific configuration, what environmental and industrial conditions push them towards that configuration and how it changes over time as a result of both changes in the firm's resources and competencies and external (environmental and industry) factors' (Cerrato et al., 2015). Although originally developed for large organizations, the configuration approach has been adapted for smaller and entrepreneurial organizations (Covin and Slevin, 1991; Gartner, 1985; Snuif and Zwart, 1994; Woo et al., 1994). Korunka et al. (Korunka et al., 2003) tries to develop a typology of startup process configurations. Each startup process can, therefore, be described using a profile of aspects four configuration areas (personality, personal resources, environment, and organizing activities). As a result of these discussions, strategic fit (or strategy configuration model) could be associated with startups. Providing organization development with necessary explanation is necessary for strategic fit measurement.

## 4. Growth stages of start-up

Scale up as a development-stage business, specific to high-technology markets, that is looking to grow in terms of market access, revenues and number of employees, adding value by identifying and realizing win-win opportunities for collaboration with established companies (Figure 1).

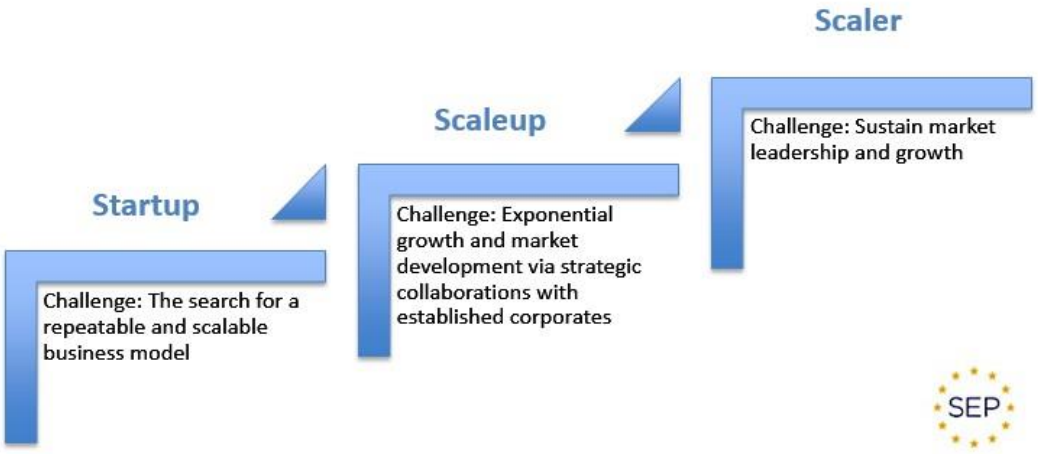


Figure 1. Stages of company growing (Onetti, 2014)

Aligning with his definition of a startup, a scaleup is past the search phase and rather in the execution phase of the business model. Also, the World Economic Forum assesses the challenges affecting businesses in expansion and stresses the importance of the scale-up phase after the startup phase. This definition then lends itself to the startup ecosystem as the foundation. Scaleups exists on top of a solid startup ecosystem. Accelerated Scaleup Methodologies. Lean startup methodologies help startups search, find, and enable repeatable scalable business models fast and at an affordable cost – advocating for failing quickly. Lean Startup methodologies are to validate a business model hypothesis as Accelerated Scaleup methodologies are to identify the right counterparts and execute growth opportunities—thereby fulfill the ultimate goal of having started up in the first place (Onetti, 2014).

## 5. Factors that positively influenced the development of companies

The authors believe that during the growth stage of the start-up manager/owner must pay additional attention to the team (since company structure is becoming more solid, for more information flexibility and controllability issues from Adizes, 2013). It is proven also by a number of scientific theories. For instance, Sahlman believes that people are just as important as opportunities and deals (Sahlman and Stevenson, 1992). Timmons in his model includes three more important cornerstones, which describe the entrepreneurial process – opportunity, resources and team (Timmons, 1999). However, there are several fundamental important factor groups' relationships describing a successful entrepreneurial process. Having analysed sources of scientific and business literature, as well as several studies on the topic of success factors affecting entrepreneurship. All of the above shows that manager/owner will face the "value allocation challenges". These situations are regarded to other stakeholders. Obviously, the complexity of decision-making processes concerning values should be recognized. Together with company development, the communication process that provides a more advanced mechanism for exchanging information with stakeholder providing their interaction as decision-makers starting to appear. The overall result will be the greater input from stakeholders and their support for the decisions that are taken.

Company managers deal with the key issue of identifying the relevant stakeholders, and possibly defining different engagement strategies for different groups. Gardner (Gardner et al., 1986) proposed a classification based on two levels of interests and two levels of power and suggest different engagement strategies for the

various groups. This will bring new "stakeholder participation level" where the directly interested groups become more powerful. Different techniques and tools may be used to engage actors in the process. Selecting the most effective set of techniques of engagement is crucial to the success of the whole process. Not only may inappropriate techniques be ineffective but, in some circumstances, they may create unnecessary barriers (Buysse and Verbeke, 2003). Above mentioned values will affect the success factors for the model of the entrepreneurial process putting additional accents on its elements (Table 1).

Table 1. Stakeholders values affecting success factors role in entrepreneurial process (Argandona, 2008)

| **Description** |
|---|
| **Economic extrinsic (economic) value**. Created through collaboration among employees and may be appropriated by either side, as we explained earlier. |
| **Intangible extrinsic value**, which is provided by the company, e.g., recognition, some kinds of training, etc. This is not part of the economic value created by a company, although it may be a form of participation in intangible value (e.g., the personal status that comes from working for a highly regarded company). |
| **Psychological intrinsic value**, such as satisfaction with the work done. It is not part of the economic rent creation process and cannot be appropriated by the company or other stakeholders, although they may help to create or destroy it. |
| **Intrinsic value** that takes the form of operational learning (acquisition of knowledge and capabilities). This is created in the agent, not in the company, but probably with the cooperation of other stakeholders. It is not part of the economic value created by the company, although it may contribute to the creation of economic value in the future. It may also be a (partial) substitute for economic value. |
| **Transcendent value** which consists of evaluative learning. This is generated in the agent himself as a consequence of his own decisions. It alters the agent's ability to assess the consequences of those decisions for him and for other agents. It is not part of the economic value created by the company; it cannot be appropriated by the company; and employees create it in themselves, even if they do not seek or expect it. |
| **Value that consists of positive or negative externalities,** i.e., a value that is felt by agents other than those with whom the relationship or transaction is conducted. For example, relations between employees and the company may result in harm to the environment; or they may generate knowledge that spills over to other people; or they may motivate others to engage in corrupt acts (bad example), etc. |

The authors of the article reached a conclusion that based on values recognised and incorporated by the company manager will affect success factors role. The authors chose Timmons model as the best system at describing and depicting the success factors groups influencing the entrepreneurial process and what they entail. But since, Timmons says: "at the heart of the process (Figure 2) is the opportunity, not all factors are linked to opportunities. Factor group relationship recognition and evaluation are crucial for success. By the authors' opinion, an important characteristic of factor relationship is provided by stakeholder value allocation principles. For the entrepreneur, at the early stages of development, maximizing economic value for certain stakeholders is obvious. But it does not guarantee maximum value for each individual stakeholder; it does not even guarantee an efficient and fair distribution of value.

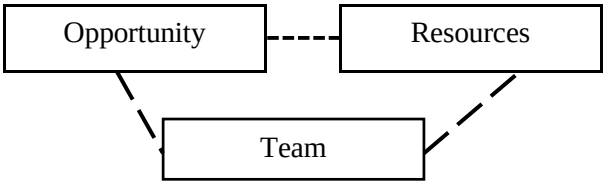


Figure 2. Timmons Model of the entrepreneurial process (Vyakarnam and Hartman, 2011)

Therefore it is needed to consider how value is shared, distributed, appropriated or captured for certain company development stage. For example, resources which are scarce for start-ups is a tool to exploit opportunities, and

here manager will face manager/owner conflict due to economic value allocation problem. At the other hand, the entrepreneurial team is a key ingredient for success, providing additional value for them will build the more stable structure. Good opportunities are that there is as understanding market demand for the product or service because of its value-added properties and that it will generate money either as a profit or as a means of creating self-sufficiency for not-for-profit organizations. Meanwhile, the team requires determination and persistence, tolerance of risk, ambiguity and uncertainty, creativity, team focus of control, adaptability, opportunity obsession, leadership, communication (Vyakarnam and Hartman, 2011).

As a result of the study of scientific, business literature, and information, including studies of leading economists and specialists, the authors have determined a range of factors that influence the successful development of companies (Ščeulovs, D., Gaile-Sarkane, E., Rozenbergs, 2014).

## 6. Success factors of Latvian companies: "Success code" configuration model

To find out the factors that affect the success of a start-up company in business, the authors of the article have performed an empirical pre-research with the aim of finding out the factors and conditions affecting the creation of a company, as well as their successful start-up and the transition into the stage of "a new company".

The pre-research is based on the survey conducted by IDAL "Success code" (LIAA, 2012). The survey dealt with twelve of the most successful companies in Latvia representing various sectors (creative industry, IT fields, representatives of the production and other fields), with the owners and/or managers whereof in-depth interviews was conducted. The surveyed companies have competitive products, which are sought after in Latvian and foreign markets; stable and growth-oriented financial indices pointing to successful entrepreneurship of the companies. As a result of the survey, several factors were identified related to the role of generation and development of an idea, clients and communication with them in business processes, the importance of the company's founders and team, etc. To examine data validity, the authors of the article used a data analysis performed with QDA Miner (Reynolds and Curtin, 2011) statistical analysis software. Out of specific factors specific keywords could be determined (depending on their weight) in the software during the analysis. According to identified keywords, factors were found in the whole text corresponding to these keywords.

As a result, the factors grouped by the authors of the article were grouped and hierarchically arranged depending on their importance. The factor groups are: the idea (factors related to the idea); the team – people (excluding the manager-founder); the manager-founder; the entrepreneur; clients and the market. The authors agree to this grouping because in company development it is vitally important to have an idea to begin the business with and to capture the market; the manager (founder), who is able to excite with the idea as well as to convince and lead the team. And the team itself, believing in the product and able to sell it on the market. Finally, a company cannot exist without the clients, their feedback and purchases, but these are external factors and the authors excluded them from the research. The authors of the article have modelled together success factors obtained as a result of the study, by modifying Timmons Model (Vyakarnam and Hartman, 2011), dividing them into four groups – Entrepreneur, Opportunity, Team and Resources (Figure 3). It could be explained with the fact that all companies, regardless of their considerable achievements on markets, are recently established. During the startup stage, it is the idea that is the most important, which is then materialized into a product.

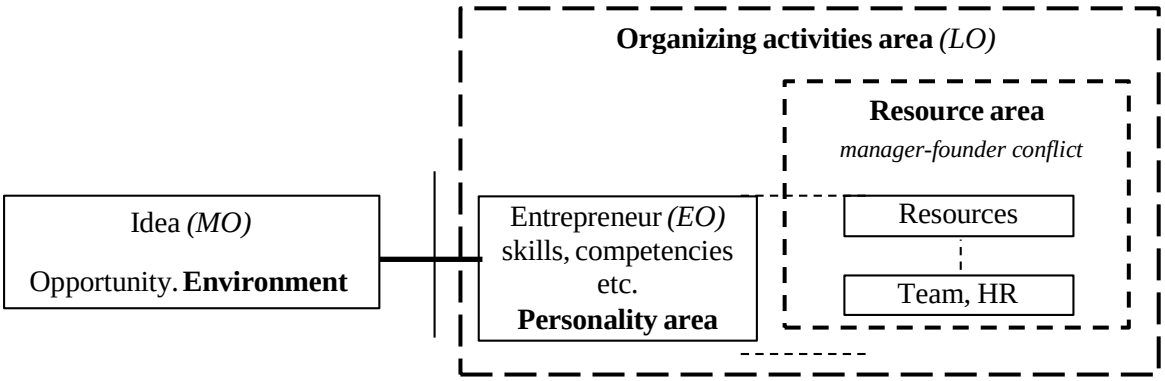


Figure 3. The authors' created model based on Timmons Model (Vyakarnam and Hartman, 2011), configurational areas (Korunka et al., 2003; Woo et al., 1994) and strategy orientations (Deutscher et al., 2016)

Lately, during growth stage, other factor becoming more important. In grouping the factors, the authors of the article would like to maintain that entrepreneurs' competencies play significant role (Table 2).

Table 2. Factors that positively influenced the development of companies (Success code" (LIAA, 2012) survey results)

| Factor group | Number of factors |
|---|---|
| Idea, opportunity (clients and the market) | 23 |
| Entrepreneur | 40 |
| Team | 28 |
| Resources | 6 |

The factor group "Opportunities" include factors that are related to the idea, a product, market opportunities, etc. Furthermore, all companies are SMEs, in which the team and team-related aspects play an important role. Companies are aware of resource importance and necessity, but due to the fact that they are in the development stage, precaution is observed when attracting bigger financial resources—companies choose to rely on their own potential during this development stage. The same applies also to other resources. The article authors point to that resources and financing sources are necessary, which, as a result of analysis, were not estimated as important. As a limitation, the authors underline that some factors explain entrepreneur and idea relationship (e.g. engaging rational and intuitive thinking in the process of creating an idea) so they could be interpreted as a process characteristics. Therefore, the authors will perform further factor analyses in the upcoming studies to a group and classify success factors model affecting long-term development of business.

## Conclusion

The economy of Latvia, just like other EU countries, is based on SMEs. The number of SMEs increases in Latvia each year. Moreover, the financial indices of SMEs over the last few years have improved. All of these facts point to economic recovery after the global crisis. As startups develop, there are several factors that determine their successful operations. Several scientists and specialists, when performing studies about business success, point to the importance of the company stakeholders' role, characteristics, abilities, knowledge, etc., their mandatory participation in all business processes, in particular during the initial stages. The team also has an important role and only the founder can form that team. Team members must be creative, flexible, and competent, because startups have very limited resources, including human resources. The empirical pre-research survey conducted by the authors allowed identifying several factors affecting a company's long-term development. According to an analysis performed by QDA Miner, the factors were divided into four groups. The authors of the article performed factor grouping based on the Timmons model. The authors point to that the factors described and grouped in this article will serve as the grounds for further studies, in which the authors are to perform factor

classification. The named factors are mutually related and must be considered as a whole and not separately (due to configurational theory perspective). Research results are underlining entrepreneurial element (EO or Personality area) significance for start-ups success. The thesis set forth by the authors is proven with the study on the success of Latvian companies, determined by various factors identified by the authors of the article.

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