

# **DYNAMIC CAPABILITIES, MARKET ORIENTATION AND TRANSFORMATIONAL LEADERSHIP: A QUALITATIVE STUDY**

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## **Abstract**

As firms find themselves today in a turbulent and ambivalent environment facing the next-generation competition, their ordinary capabilities and reactive market approach are not often enough. This study examines levels of dynamic capabilities, proactive and reactive market orientation, and the impact of transformational leadership. It also aims to provide a better understanding and examples of their implementation. Based on in-depth interviews with eight managers amid the COVID-19 pandemic, ordinary capabilities are not sufficient for firms to achieve sustainable competitive advantage. Dynamic capabilities are important for exploiting market opportunities, however, transforming capabilities seem to be the least developed part of firms' dynamic capabilities. Furthermore, firms use predominantly responsive market orientation, while proactive market orientation is used mostly at the beginning of the business or after firms experience outside pressure. It shows that market orientation should not be seen statically, but its levels and proactivity change dynamically over time. Transformational leadership seems to be a critical factor for firms to drive the market.

**Keywords:** dynamic capabilities, market orientation, transformational leadership

**JEL Code:** M10, M31

## **Introduction**

Market orientation theory has evolved in the last decades, from focusing on customer needs and competitors to proactivity and the market-driving approach (Narver et al., 2004). Based on market orientation, managers use dynamic capabilities and decide on strategic changes and orchestrate organizational assets. Therefore, transformational leadership as a facilitator of extra efforts, creativity and ways of thinking (MacKenzie et al., 2001) may influence the relationship between dynamic capabilities and market orientation. However, the relations between these three components remains unknown. This study aims to investigate

relations between dynamic capabilities, responsive and proactive market orientation, and the impact of transformational leadership on the relationship.

### **Dynamic Capabilities**

Dynamic capabilities create or modify ordinary capabilities by orchestrating internal assets or acquiring them externally. Three types of dynamic capabilities can be distinguished. (1) Sensing capabilities serve the firm to identify opportunities and threats affecting the ability to continue successfully in the market. It consists of obtaining information about trends, consumer needs, industry changes, competitors, or new technologies. (2) Seizing capabilities are based on strategy, internal resources, knowledge and skills, and external knowledge gained through sensing capabilities. Firms evaluate the information gained from their environment and decide whether and how to respond and take advantage of market opportunities. (3) Transforming capabilities are needed for reconfiguration of organizational tangible and intangible assets as the implementation of the new strategy or business model may often require an adequate organizational redesign. Transformational capability is the ability to execute change (Kump et al., 2018).

### **Responsive and Proactive Market Orientation**

A firm is market-oriented if it obtains and works with information relating to current and future needs of customers, activities of competitors, disseminate this information between departments, and responds as a whole (Kohli and Jaworski, 1990). The basic characteristic is the organizational culture in which all employees are constantly focused on creating value for customers. The most important patterns of behaviour are customer orientation, competition orientation and coordination between individual functions (Narver and Slater, 1990). According to Narver et al. (2004), market orientation is not only responsive, thus it does not only follow and satisfy the current expressed needs of customers. Market orientation is also proactive, focused on tracking, identifying and satisfying the latent and future needs of customers.

### **The Role of Transformational Leadership**

Transformational leadership can be defined as the ability to lead through employees identified with management, creating a followable vision, stimulating thinking and creativity in the firm, and understanding the needs of employees. It consists of several components, which are idealized influence, inspirational motivation, intellectual stimulation, and individual

consideration. Dynamic capabilities and market orientation are driven by managers and sponsored by leadership. Strategic change and driving the market environment requires vision, clear values and communication to employees (Avolio and Bass 1999). The leadership team should create a culture that encourages creative thinking, cross-functional collaboration, innovation or tolerating mistakes (Stathakopoulos et al., 2019). This could be a problem especially in SMEs where owners do not have an understanding of the above-mentioned concepts and their management teams tend to lack the competency to lead the agenda and sponsorship (Novinský et al. 2016).

## 1. Methodology

This study is based on online in-depth interviews with eight managers in the CE region. Four respondents were from FMCG, the rest was from IT/Real Estate, travel, fashion and consulting industry. Two respondents are founders working in management, five respondents work in large firms in local managerial positions, one respondent work as a consultant especially for large firms. The summary of respondents is provided in Tab. 1.

**Tab. 1** Respondents and firms

Firms	Industry	Size	Department	Reporting abroad
Firm A	FMCG	Large	Sales	Yes
Firm B	FMCG	Large	Sales	Yes
Firm C	FMCG	Large	Sales	Yes
Firm D	FMCG	SME	Founder	No
Firm E	IT/Real Estate	SME	Business Dev.	No
Firm F	Travel	Large	Business Dev.	Yes
Firm G	Fashion	SME	Founder	No
Firm H	Consulting	Large	Consultant	Yes

Source: author

The interviews took place in Q1 2021. The duration of the interviews ranged between 50 minutes and 90 minutes. An interview guide was developed and a semi-structured format of the interviews was used based. Interviews were recorded via Webex, transcribed verbatim and anonymized. Interviews were analyzed following Spiggle's (1994) analytical approach and recommendations to categorize, abstract, compare and iterate

## 2. Findings

In-depth interviews with eight managers provided practical examples shedding light on the levels and relations of dynamic capabilities, market orientation and transformational

leadership, and how firms apply the market-driving approach. Findings are divided into three separate blocks and elaborated further below.

## 2.1 Responsive and Proactive Market Orientation

Based on the interviews with managers, if there are not many competitors in the market, or the firm has a strong position in the market, ordinary capabilities will be enough to maintain its position for some time. After a while, however, competitors can also learn these ordinary capabilities. A firm needs strong dynamic capabilities to regain its position. Also, the majority of the interviewed managers agree strong dynamic capabilities are needed especially at the start of the business, or to ensure further growth

*10 years we drove change through technological innovation in the industry [...] Subsequently, we made only minor adjustments to the business model, finetuned our operations, however, a major transformation was no longer done. For the last 3 years, we have seen it is no longer enough, the competition is stronger and we need to do another transformative change.*

*We need to implement changes that will allow us to further scale our business and growth. Every firm must implement changes to grow.*

Managers suggest dynamic capabilities get activated by external disruptions in the form of new technologies, changes in consumer behaviour or demand. These disruptions, if the firms possess strong dynamic capabilities, would result in a change of strategy or business model. Reasons, why firms overlook their environment, can be excessive concentration on operational management or relying on past successes. Nevertheless, massive disruption in form of COVID-19 accelerated the change initiatives.

*Due to the COVID-19, we lost most of our demand. But we still have staff in our call centre. We need to be more flexible - trying to reduce call centre by allowing customers to place an order online. This would have a significant impact on profitability. [...] We worked on the transition to the digital environment before COVID-19, but it was the pandemic that accelerated the whole process.*

*From my experience, firms that are not developing well have the problem of focusing too much on operational, day-to-day matters and doing what has worked for them in the past.*

The interviews suggest that firms have rather strong sensing capabilities. All of them observe customers and their needs, some even let them choose what the product will look like. It is natural that firms monitor the competition and its activities. Firms also realize the importance of disseminating the information both informally or during formal meetings.

*We ask customers what they want. We give them a list of options for what our product should look like, and we do what they choose.*

*We monitor new products. [...] We visit trade fairs, monitor our customers and ask them about their needs [...] we visit points of sale, we also look inside delivery vans when they stop somewhere [laughter]. [...] We have such a culture, where we share everything [...] we have regular meetings and an online platform where we share current interesting news and ideas.*

Seizing capabilities take the form of a trial-and-error approach as all interviewees concur. Opportunity evaluations often take place based on clear criteria. The ability to respond to small and medium-sized changes is relatively fast. Nevertheless, firms face sometimes insufficient prioritization. Another problem is the internal capacity.

*When our customers want something or we see that a particular product or innovation might work, we try it. We apply the try-fast-fail-faster approach.*

*We judge market information from three perspectives: strategic importance – if it strategically develops our business, business importance – if it makes economic sense, and general importance – is it a category or product we do, we want to do or we can do.*

*We can decide on small and medium changes at regular meetings or 1on1. However, decisions on medium changes should already have some formality based on priorities and be more coordinated. Sometimes no one knows what was the priority 3 weeks ago and then we hit a limited capacity.*

Transforming capabilities are used the least and seem to be the weakest as interviewees shared many unfinished or unsuccessful attempts to larger strategic change. Transforming relates to major changes, which are the slowest to implement. Firms often face a limited capacity of resources and skills. The greater the extent of change, the more it manifests itself. It often seems as if firms prevent change and do not want to transform themselves. They rather focus on regular optimizations of current operations.

*We did not go to some projects due to financial capacities, human resources, insufficient knowledge or logistical possibilities.*

*We often try to change the strategy with existing abilities. However, this does not work. It would be more appropriate to acquire new capabilities – new organizational structure, distributional, new knowledge, new product formats. But that is not happening or the change is too slow.*

*We decided to introduce a new service and we failed – from the point of view of management, procedurally, financially, know-how ... and we had to end it.*

*Every interesting market will be saturated over time. It is important to focus on the core business and to be constantly innovative and build extreme ownership in employees. Often, firms focus*

*too much on core business, or it fails to communicate the strategy or change projects well and encounters organizational resistance.*

## **2.2 Responsive and Proactive Market Orientation**

It seems that market orientation cannot be viewed statically, but needs to be perceived dynamically over time. Market orientation may evolve, the level of proactivity and reactivity changes. Market orientation can also be viewed not only from the perspective of the business unit as a whole, but we can also assess it from the perspective of the department.

*It depends on the time. Our firm was super proactive 10 years ago at the beginning of its existence. But last years we have been more like an "incumbent" firm, that does it its way. [...] There is no big innovation anymore.*

*In the marketing department, we are very proactive. [...] In the product department and with innovations we are rather reactive.*

Based on the responses of managers, firms show a strong responsive market orientation. All of them observe customers and their needs, some even let them choose what the product will look like. Everyone monitors the competition and its activities. Firms also share market information inter-departmentally. Managers mention that firms perform more responsive activities most of the time. Once a firm is successful, it often limits proactivity. The main activities focus on the optimization of the core business and gradual adjustment according to customer requirements.

*Sometimes it seems to me that our firm knows about trends, but waits for the trend to be confirmed or for the opportunity to grow to such a size that it can reactively enter.*

*Starting a business we were proactive. But recently, we were responsive riding on a successful wave. With COVID-19 in our back, we were proactive, but because we had to. We needed the trigger.*

It seems that proactivity, as well as dynamic capabilities, are needed especially at the beginning of the firms' existence and during its development and growth. Managers often confuse proactivity with dynamic capabilities.

*A company can only be successful at the start of its business if it has a proactive approach. If it is only responsive, it cannot succeed.*

Most of the managers stated they are inspired by foreign markets. They follow trends, innovations or business models, which they try to introduce in the local markets as well.

*In Germany and the Netherlands, most of the business in our industry is done online, in Scandinavia almost 100 % of the business is online. Here we have 10 % of the business online, it is gradually coming and we need to be the one who drives it.*

### **2.3 Leadership: Critical for the Market-Driving Approach**

All the talks with managers showed dynamic capabilities and market orientations must be pushed by leadership. Clear sponsorship and leadership involvement are necessary for transformation.

*Our CEO comes up with ideas and puts a lot of pressure on how to change the business model or how to innovate to match the trends we see, for example, abroad.*

*Our competitors are bigger than us and they have been here for a long time. They started in the 90s, the owners get older and do not follow trends. Maybe they see them but consciously ignore them.*

Some managers also think a change in the leadership team is sometimes needed. Either for a new impulse, so that the firm can perceive things from a different perspective, but also for the firm can outgrow the original leadership team capabilities over time.

*The old management still lived a bit in the past and they were reluctant to change things that worked before. It took new people from the outside to crack it and show a vision of what our business might look like. But also to be able to drive this agenda internally.*

The interviewed managers often mentioned these characteristic features of transformational leadership concerning dynamic capabilities and market orientation: goes beyond self-interest, emphasize the collective mission, raise awareness about important issues, seeks different views and angles, individualizes attention, teaches and coaches.

## **Conclusion**

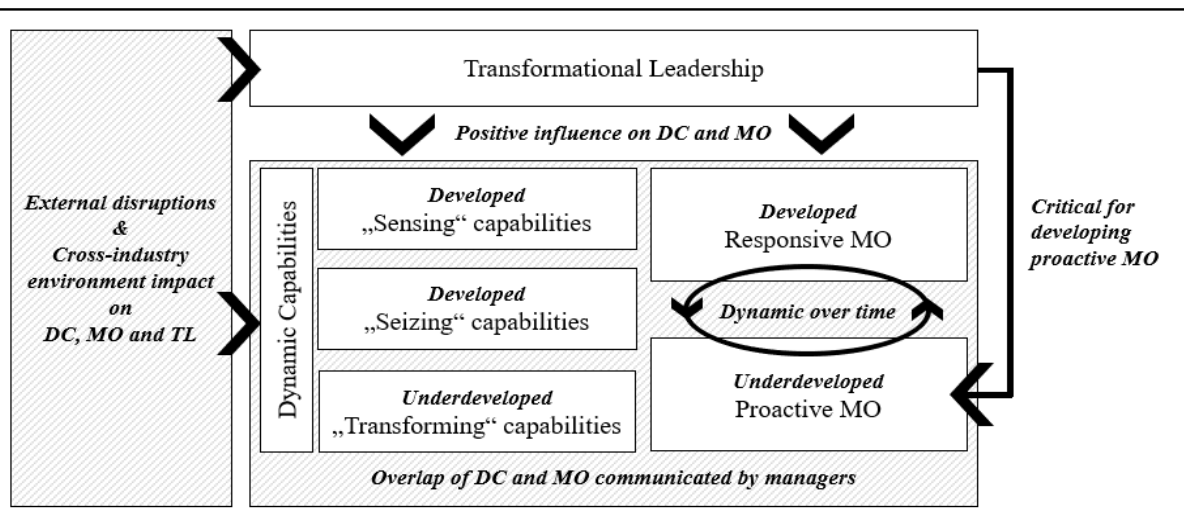
This study shows that the dynamic capabilities are relatively developed in terms of sensing and seizing. However, transforming capabilities appear to be underdeveloped and reduce the ability to create new ordinary capabilities or seize market opportunities. Firms often resist change and overlook their environment, transform slowly or with difficulty. Managers often confuse these concepts of market orientation and dynamic capabilities. Sensing capacity often overlaps with market orientation in terms of monitoring customers, competitors and internal data sharing within the firm.

Interviews with managers also reveal that firms use primarily responsive market orientation. Most respondents shared the view that their firm was proactive especially at the

beginning and then became mostly responsive optimizing and improving the existing core business – products, strategies and business models. Firms are often torn from the status quo only when external disruption occurs.

The last finding shows transformational leadership enables dynamic capabilities and market orientation to function properly towards market-driving and sustainable competitive advantage, through sponsorship by the leadership team, clear vision, creating a culture that supports the change and new thinking, and through proper internal communication.

**Fig. 1** Summary of Findings



Source: author

## Limitations and Future Research

This study and its findings are based on interviews with eight managers from various industries, and therefore has an exploratory character with no intention to generalize. The goal was to gain a deeper understanding of how managers perceive dynamic capabilities, market orientation, and the role of transformational leadership in today's turbulent times, and how these components help to achieve a long-term competitive advantage. Thus, the findings of this study do not present statistically representative conclusions.

This topic should be further validated through a quantitative study. Future research should determine what are the relationships between the individual components – dynamic capabilities as the antecedent of market orientation and transformational leadership as a mediator of the effectiveness of dynamic capabilities and market orientation relationship, and their impact on market-driving capability and performance.



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