

# The Configuration Approach to the Strategic Management of Small and Medium-Sized Enterprises

**Josef Mugler**

Department of Small Business Management and Entrepreneurship, Vienna  
University of Economics and Business Administration, Augasse 2-6, A-1090  
Vienna, Austria

*Abstract: The configuration approach to the strategic management of small and medium-sized enterprises (SMEs) is presented as an alternative to the traditional approach of industrial economics. The configuration approach combines the traditional market-based view with a resource-based view of strategic management theory, stimulates the consideration of interdependencies instead of unidirectional dependencies, and takes into account the timing of strategies within the business life cycle. The configuration approach thus provides a suitable frame of reference for SME and entrepreneurship research as well as education and training in entrepreneurial behavior.*

*Keywords: configuration approach, strategic management, small and medium-sized enterprises (SMEs), entrepreneurship*

## 1 The Challenge of Strategic Management in SMEs

The SME sector has shown steadily increasing numbers of enterprises and employees in the traditional market economies of Europe for many years, and in the new market economies since the fall of the Iron Curtain in 1989<sup>1</sup>. In most regions of Europe, however, entrepreneurs, representatives of small business associations and politicians are complaining more about threats than about opportunities. Indeed, there has always been turbulence within the sector: Entry and exit rates (measured in terms of stock turnover) are around 10% on average.<sup>2</sup> A small number of fast-growing new businesses and a large number of self-employed entrepreneurs and micro-enterprises have provided many new jobs, while downsizing and streamlining have reduced the number of jobs in large businesses. Industries which provided secure income for generations in traditional

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market economies (small trade, crafts, agriculture) have now declined, whereas new types of businesses and entrepreneurs have appeared in the course of the development of new technologies and new markets.

Economists are often urged to forecast which sectors or types of SMEs will be profitable in the future, which ones will at least survive, and which ones will be replaced by large supply chains, by more aggressive marketing concepts, or by new IT-based selling. Which factors will influence success for SMEs in the years to come? Both entrepreneurs and politicians hope for an easy and reliable answer. However, such an answer would either be wrong or very abstract, leaving space for a wide range of possibilities. Neither option is particularly helpful to the type of businessman/woman who expects or even needs concrete recipes for orientation. However, entrepreneurs who merely want to follow recipes are, by definition, not true entrepreneurs. Even imitators of rewarding business ideas usually do not simply copy well-proven recipes but transfer the core of such ideas into new environments or adapt them to different requirements.

One simple success factor which has proven itself theoretically as well as empirically is a large market share.<sup>3</sup> Consequently, firms are advised to strive for a monopolistic market position. SMEs, however, are often said to be too small for such positions in relatively free, open, and in some cases already globalized markets. Consequently, SMEs would need relatively small market niches if they wanted to attain a large market share. However, many of them suffer from a lack of specialized technologies, of human resources, and of knowledge on how to approach specific markets.

Management schools and gurus have developed a number of strategic actions recommended to SMEs and large companies alike.<sup>4</sup> The target group of consultation for strategic management primarily includes those who can afford the cost: large companies, business associations and governments, but not individual SMEs. They cannot usually afford the cost of enterprise-specific strategic analysis and tailor-made strategy development. Does this mean that SMEs must rely on the same standard strategies as large enterprises and have no alternative to copy them? This would have two strange implications:

- First, SMEs would follow recommendations for strategic development that are not designed for their organizational characteristics, assuming that small firms are essentially different, that is, not just smaller versions of large firms;
- Second, the function of entrepreneurship would thus be relegated to planning experts, private or even public, which would seem to run counter to the real mission of entrepreneurship in a market economy: Entrepreneurship could even be characterized as the alternative approach to finding an enterprise's way into the future: by discovering new markets, invent and place new products and services in these markets, and invent technologies for producing these products, tangible and intangible.

Therefore, SME consulting needs to focus more on processes than on contents which only need to be copied or transferred. Well-educated and creative entrepreneurs will proceed more autonomously and effectively than self-employed businessmen who have less entrepreneurial talent and whose economic activity arises more out of need, as in the case of unemployment, or out of the desire to fulfill the expectations of relatives or other stakeholders, than tentative behavior based on intrinsic motivation.

From a more general perspective, decentralized entrepreneurship has become a specific resource for orientation in complex and dynamic environments. The decentralization of strategic decision-making is reputedly better suited to actual orientation challenges than traditional, centralized planning expertise. This argument in favor of decentralization, however, does not mean that there is no longer any need for public economic policy. What does not seem to be sufficiently clear today is how much and which economic policy is best suited. Economists are still struggling for the better approach to the organization of the economy. It will therefore depend on the choice of economic theory approaches whether politicians are seen as more or less responsible for adequate frameworks of entrepreneurial strategic decision-making.

The next steps in our argument will not include a discussion of political and economic frameworks for SMEs, rather they will start from the assumption that the enterprises' environment allows – but also demands – entrepreneurial orientation. We will first compare two main streams of strategic management and then, on this basis, introduce the configuration approach as a concept which

- is able to combine the benefits of the traditional approaches to strategic management;
- focuses on the process of developing strategies (instead of strategic goals);
- is well suited as a frame of reference for SME and entrepreneurship research as well as for education and training in entrepreneurial behavior.

## **2 The Traditional View of Strategic Management: Strengths and Weaknesses**

In strategic management, several schools of thought are currently struggling for superiority within the scientific community.<sup>5</sup> We can roughly divide these schools into two groups:

- Approaches which focus primarily on environmental influences (mainly industrial economics, market-based view)

- Approaches which focus primarily on the influence of available, disposable resources (mainly resource-based view)

The main question in strategic management based on industrial economics has been: How can we better adapt to the characteristics of markets in certain industries? This is the core question of the so-called **market-based view**.

This is a relatively easy question in stable markets: Those who are better at analyzing their markets and adapting to given market characteristics will be better off. However, markets are not stable, not nowadays and not for SMEs. Therefore, better market analysis does not suffice, or perhaps it addresses the wrong question: Today's enterprises also need strategies to find, influence and even create favorable markets. When market characteristics are unclear or in a state of turbulence, business success cannot simply be based on the better answer to a well-defined question (i.e., a given market), or in other words: the answer to a question that itself is not questionable. Adapting to new market conditions is not a question of single-loop learning, that is, of learning how to avoid failures within a well-defined procedure, but a question of double-loop learning: learning how to break out from well-defined routines that are no longer adequate because situations, problems and challenges have changed.<sup>6</sup>

The dynamics of markets, partly influenced by changes in customer needs and preferences, partly influenced by new technological and political developments which have opened and integrated formerly separated markets, have made it increasingly difficult to forecast market characteristics as a precondition for adequate marketing strategies. The dilemma of specialization and flexibility has become critical. Specialization in market characteristics requires time for adaptation. Dynamic markets, that is, those which involve rapid changes in market characteristics, however, call for high speed in adaptation and high flexibility of resources. The dilemma of specialization and flexibility is thus accompanied by the dilemma between rapid change and slow adaptation speed.

Not surprisingly, the **resource-based view** of the enterprise has aroused increased interest in the field.<sup>7</sup> The core assumption of this approach to strategic management signals a radical shift: It is not a certain industry (or a specific, well-defined market) which forces a company to react and respond with an appropriate marketing strategy, but the availability of resources for a better understanding of what is going on inside and outside the company. In order to understand, one needs to interpret what is going on. Different people with different points of view may deliver different interpretations, which means that the object of understanding cannot not be only one "true" or "real" environment, but constructs of differing environments created by intelligent "resources". These resources select and give meaning to incoming signals and activate responses to these constructs within the organization. In this sense, strategies do not turn out as causal reactions to "true" market characteristics, but as options for interventions in ongoing developments (inside and outside a firm). Intelligent resources must not narrow our view to one "right" path, but open our minds to possible alternative

paths into the future. The appropriate entrepreneur for turbulent environments can be characterized as a person who continuously interprets signals and thinks about alternatives.

This shift in the view of crucial success factors from outside to inside, from market forces to resource-based potentials, and from adaptive to proactive intelligence, coincides with the shift from the traditional positivistic approach in epistemology towards an approach called radical constructivism: What we actually take in from our environment is not a prefabricated external message, but an internal construct created by an individual or by a communication process between individuals. In other words, it is the recipient who ultimately defines the content of any information, not the sender.<sup>8</sup> This ability to construct is generally based on the long-term development of the hardware "brain" and the software "intellect" and differs, of course, according to the talents and the socialization process of the individual.

What does that mean for the strategic management of SMEs? In SMEs, the personality of the entrepreneur is often far more critical to the selection and interpretation of signals for a logically plausible construct than in the case of top executives in large firms. There are fewer filters between incoming signals and the interpreting intellect in SMEs than in large firms. In SMEs, far more interpretation is based on direct observation, oral communication, and direct signals from the micro-social environment (friends, family members, key employees who sometimes even have the status of quasi family members), whereas in larger firms teams of professional analysts and consultants prepare and influence interpretations by the senior management. In SMEs, the entrepreneur not only has the role of the interpreter, but also the role of the actor. There are not only fewer filters between signals and interpretation, but also fewer filters between (strategic) decision-making and acting. And, not to forget, top executives in large companies can be replaced more easily in cases where essential signals are misinterpreted or decisions are not carried out adequately. The owner of an SME generally will not replace him/herself in cases of failure.

Traditional strategic management theory has been based on the concept of causal relationships between market characteristics as well as the response and performance of the enterprise. The unidirectional causality chain was supposed to function in the following direction: Strategy follows industry (market), "structure follows strategy"<sup>9</sup>, and performance follows structure. Consequently, the focus of management research has been directed more toward unidirectional dependencies which could easily be modeled by equations of the kind:  $e = f(x)$ . Statistical data analysis has made great progress in applying linear equation methods to economic and social problems. Correlations between data observed and results measured in social contexts have been interpreted in a way similar to causal relationships in technical contexts.

However, a number of arguments suggest that this positivistic concept of unidirectional relationships is not adequate for a large number of questions in the

social and economic sciences, including many questions regarding the strategic development of SMEs: The large number of enterprises, their high degree of heterogeneity, their various environments and the different characteristics of entrepreneurs – to mention but a few of the criteria – call for a concept that better takes the mutuality of driving forces into account. Mutuality among variables is not a completely new concept, but it has been neglected by mainstream management research in recent decades.

On the other hand, interdependencies among variables are far more difficult to model and to measure than dependencies. Some progress has been achieved by applying non-linear equations and chaos theory, both of which are attracting increased interest among researchers who are used to applying quantitative methods. The merits of quantification in "management science" are not to be neglected: We owe a great deal of progress in rational decision-making to these methods. However, some scholars have claimed that this trend has brought about more insight into what was measurable instead of what was important. Other scholars have responded that if relationships between variables cannot be measured, the scientific basis is lost. This may still be a point of discussion today when considering the aptitude of a concept based on interdependent driving forces for social research. However, in the education and training of entrepreneurs, the concept seems promising without any restrictions.

A more concrete concept based on the mutuality of driving forces for the strategic development of a firm is the configuration approach.

### **3 The Configuration Approach –Main Characteristics and Adaptations for SMEs**

The configuration approach belongs to the type of methods characterized by terms such as holistic, universalistic, integrative, synergetic, systemic, and the like. The roots of the configuration approach can be found in older approaches which were swept away from the mainstream of business administration in favor of up-and-coming quantitative methods.<sup>10</sup> Concepts of this nature lost influence in the second half of the 20<sup>th</sup> century. Nowadays, similar but modernized approaches are arising in German as well as English management literature.

In the English-speaking world, many scholars who attempt to apply a holistic approach to strategic decision-making refer to the configuration approach, which was (re-)formulated by Miller<sup>11</sup> and others.<sup>12</sup> This approach seems to be well suited for the strategic development of SMEs as well, provided some adaptations are made.

The configuration approach does not focus exclusively on the firm's environment, or exclusively on its internal resources, but on the mutual influence of a set of variables. It tries to model interrelationships.

For the specific purposes of small firms, four groups of variables play a decisive role:<sup>13</sup>

- the environment of the firm,
- the resources of the firm,
- the personality of the entrepreneur, and
- the management system adopted.

Each of these four groups of variables is, of course, only an aggregation of a larger set of sub-variables.<sup>14</sup> The environment can, for example, be separated into macro- and micro-environments and into the social, legal, technical and economic spheres. The personality of the entrepreneur can be partitioned into traits, motivations, qualifications, etc. The internal resources of a firm can be differentiated as tangible and intangible assets. Finally, the management system consists of instruments for long-term strategic and short-term operative management instruments.

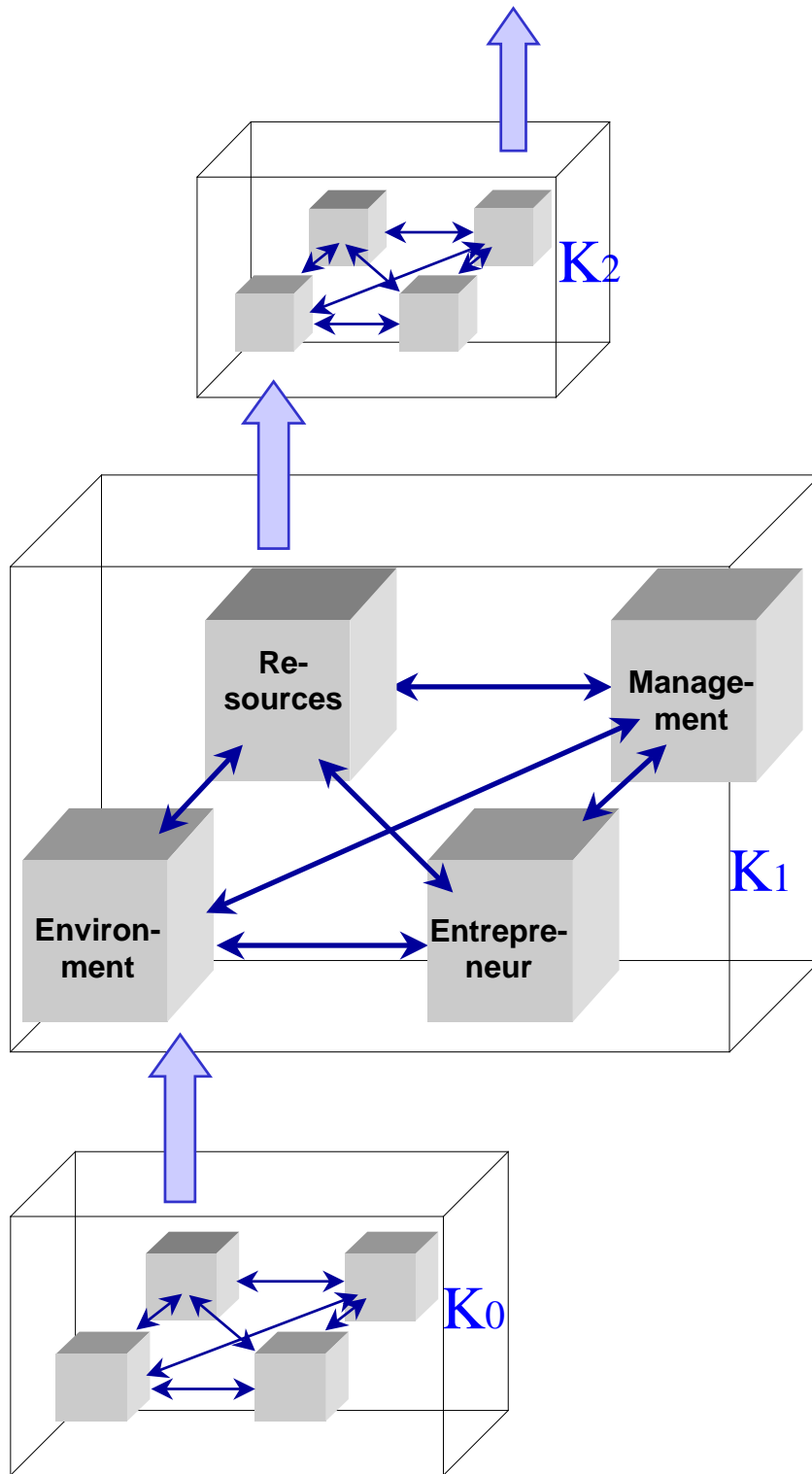
However, merely identifying and evaluating these variables is not sufficient. A vast number of interrelationships exist among most of these variables and sub-variables; some may lend themselves to measurement, while some – perhaps most – may not. It is not only the variables per se that influence the firm's performance, but their mutual effectiveness.

The configuration approach allows, or better yet *requires*, a dynamic perspective: The development of a firm needs to be interpreted as a sequence of configurations over time. The history of a company is thus the history of a chain of configurations (which is similar to one of the demands of the resource-based view). The configuration  $K_1$  in Fig. 1 has emerged from a former configuration  $K_0$  and will develop into a configuration  $K_2$  – with or without management intervention. The world (on the macro-level or on the micro-level of a certain firm or an individual) will also continue to develop without intervention by human beings. However, interventions by the entrepreneur (or by any other actor) will direct the development of the firm towards the desired configuration.

In principle, configurations are unique; however, similar configurations may allow us to create typologies. Experience with certain types of configurations can help identify the strategic position of an individual enterprise and to estimate its prospects for further development. It can also help define (or find) interventions in the sequence of typical phases in the configuration history in order to avoid dangerous paths and to move towards favorable paths. The configuration approach can thus be combined easily with the life cycle approach<sup>15</sup> in strategic management theory.

The important lesson of the configuration approach in strategic management is that strategic analysis must not be restricted to isolated variables of a certain configuration (= of a certain company), but must include the identification and (if it can be done efficiently) measurement of mutual influences among those variables. The results of isolated and unidirectional causal relationships could misguide the interpretation of a certain variable within its context, for example, the financial resources of a given enterprise. The configuration view, which – in this case – would take into account the interdependencies among financial resources, other resources in the firm, the management system, the environment, and the personality of the entrepreneur, could very well yield quite a different diagnosis. What may have seemed to be a weakness from an isolated perspective could become a strength when interrelated with other variables (and vice versa). The positive effects of interrelationship are usually described by the term "fit" in the English language, and by terms such as "*entsprechen*" or "*passen*" in the German language.





Nowadays, SMEs do not operate in easy, stable, and/or protected environments. Many entrepreneurs seem to have no idea how vast the range of possible paths into the future could be. A certain type of entrepreneur equipped with certain resources may be forced to withdraw under uncertain and/or unfavorable conditions, whereas a different type of entrepreneur with a different set of resources will succeed in the same environment. For example, we can find successful entrepreneurs in declining industries (hostile environments) as well as failing entrepreneurs in growth industries (favorable environments).

## **Conclusions**

If it is true that the performance of an enterprise depends more on how variables are interrelated than on the effects of isolated success factors, research on entrepreneurship and the strategic management of SMEs should not focus on the identification and measurement of such isolated factors, but on the identification of interrelationships among variables which push configurations from phase to phase in the enterprise life cycle. Each enterprise may have several options for a successful path into the future. Each enterprise has its unique configuration and will proceed on a unique path of development. What is left for research in such a concept is not the search for general (external or internal) success factors, but

- the search for types of configurations (a less demanding level of generalization) that typically lead to positive (or negative) strategic developments; from those typologies, entrepreneurs can derive ideas on how to find a concrete and unique configuration for the individual firm, and
- the search for instruments and procedures at the entrepreneur's disposal that allow the identification and evaluation of the concrete and unique configuration as a part of which he/she is challenged to operate.

The configuration approach is suited as a frame of reference for directing research in the strategic development of SMEs and for certain fields of entrepreneurship research. It may be even more useful as a tool for education and training entrepreneurial behavior because it forces people to train their ability to think about structured details as well as interrelationships between spheres of influence along a path of development.

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## **References**

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<sup>14</sup> For details see Mugler, J., op.cit., p. 111.

<sup>15</sup> For details see Mugler, J., op.cit., p. 100.