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Resource allocation and dynamic capabilities

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Abstract

The organizational processes that are concerned with resource allocation have been largely overlooked as a key component of dynamic capabilities that allow the firm to reconfigure its asset base (Teece et al., 1997). We bring back attention to how firms effectively allocate resources over time by proposing the concept of resource reallocation, that is, the ability of firms to redirect resources across their businesses/projects. We posit that resource reallocation is a crucial component of dynamic capabilities, as it lays at the foundation of their ability to effect change. Moreover, we claim that simply reallocating resources is not enough to constitute a sign of dynamic capabilities as that need to be accompanied by a similarly strong strategic sense in directing those flows toward the better opportunities. We study reallocation empirically by proposing a number of measures for capital reallocation activity across the firm's business units as well as for the strategic efficiency of those allocations and by testing their links to firm performance. We find a direct inverted U-shape relationship between reallocation activity and performance. We furthermore analyze the indirect effect of reallocation activity on performance through improved strategic efficiency in the firm's internal capital market.

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