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WORKING PAPER

Where Do Capabilities Come from and How Do They Matter? A Study in the Software Services Industry

Recent years have witnessed a surge of interest in the notion of capabilities as an important source of competitive advantage. This recognition has, in turn, placed emphasis on the question of where and how these capabilities emerge and how they influence firm performance. The present paper is an attempt to address this question. Using a large sample of detailed project-level data from a leading firm in the global software services industry, we attempt to empirically study the importance of capabilities. We find that two broad classes of capabilities are significant. The first class, which we label client-specific capabilities, is a function of repeated interactions with clients over time and across different projects. This learning from repeated interactions with a given client reduces project execution costs and helps improve project contribution. The second class, termed project management capabilities, are acquired through deliberate and persistent investments in infrastructure and systems to improve the firm's software development process. Our empirical results suggest that the marginal returns to acquiring different capabilities may be different, and an understanding of such trade-offs can improve firm decisions to improve and/or acquire such capabilities. We discuss the key contributions of our paper and the implications for future research on capabilities.

Keywords: Organizational capabilities, firm performance, software services.

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