

# **Business Life Cycles and Five Elements Theory**

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## **ABSTRACT**

This paper proposes a five-stage life cycle model to describe business development from birth to death with the five elements theory. A five-stage model, including birth, survival, success, decline, and renewal, is developed in terms of interactions of business functions, which are classified into the Chinese five elements. Each stage of the business life cycle could be characterized by the different combinations of the Water-Fire, Fire-Metal, and Earth-Water effects. The Water-Fire effect marks the beginning and direction of business development, the Fire-Metal effect indicates a firm's competitiveness in the industry, and the Earth-Water effect signifies its capabilities of organizational learning and innovation. The business life cycle could be more clearly understood and explained by means of these three effects. At the birth stage, firms create a profitable and sustainable vision (a new Water-Fire effect). As firms move into the survival stage, they seek to grow by developing their learning capacities (the Earth-Water effect) and increasing their competitiveness in cost. The success stage could be illustrated mainly by the strong Fire-Metal effect, which is manifested by the increasing profit and competitiveness. The decline stage is characterized by deteriorating profits and a loss of market share (the weak Fire-Metal effect) and by lack of learning capabilities. The renewing firms have to rebuild their learning and innovative capabilities (the Earth-Water effect) and shape a new profitable direction for business. The contribution of this research lies in the attempt to link interactions of business functions and business life cycles. It provides a tool to diagnose holistically problems of business development in the new economy.

Keywords: business life cycles; five elements theory; business functions, Chinese systems thinking

## INTRODUCTION

Numerous researches have focused on the life cycles of organizational development (i.e. Chandler, 1962; Greiner, 1972; Quinn & Cameron, 1983, Hanks, Watson, Jensen & Chandler, 1993; Lester, Parnell & Carraher, 2003). However, there is very literature that has attempted to explain or predict the life cycle from the perspective of systems thinking. This study features the application of Chinese five elements theory to the business life cycles. Three types of interactions of business functions in terms of the Chinese five elements will be introduced to mark out the characteristics of different stages in business life cycles. Moreover, this research will demonstrate how different stages are interrelated to each other. Finally, the process of the corporate change has been identified as the renewal stage in business life cycles and illustrated in terms of interactions of business functions.

This study aims at the search for the business life cycle in the new economy. Kolter (2003, p. 36-37) argued that the old economy was concerned with manufacturing firms whose main driver was to standardize production, products, and business processes. By contrast, the new economy, backed up by information business, utilizes information to differentiate, customize, personalize, and dispatch over networks at an incredible speed. It is obvious that old economy focused mainly on how to produce goods efficiently while the new economy highlights the significance of the innovation and marketing functions in business. Therefore, this research has attempted to reveal the relationships between the business functions and its life cycle in the new economy.

## BUSINESS LIFE CYCLES

### Literature review

Adapting the concept from the biological sciences, a number of researchers has proposed life cycles of organizational development from birth to death (i.e. Chandler, 1962; Greiner, 1972; Galbraith, 1982; Churchill, 1983; Quinn & Cameron, 1983; Miller & Friesen, 1980, 1984; Smith, Mitchell & Summer, 1985; Dodge & Robbins, 1992; Hanks, Watson, Jensen & Chandler, 1993; Kazanjian, 1988; Beverland & Lockshin, 2001; Lester, Parnell & Carraher, 2003) As one of the earlier contributors, Chandler (1962) introduced stages to a life cycle model in which he argued that as stages changed, so did firms' strategies and structures and had identified a four-stage model of organization evolution. As to the nature of stages, most authors appear to follow the idea of Chandler's (1962) landmark work, *Strategy and Structure* that organizations develop patterns of organization structure in response to common growth and market challenges. A valid life-cycle model could provide a road map for managers to identify critical organizational changes and problems as organizations grow and develop (Hanks et al., 1993; Beverland & Lockshin, 2001)

Hanks, Watson, Jensen & Chandler (1993) defined life cycle stages as a "unique configuration of variables related to organization context and structure." In their definition, common contextual dimensions are comprised of organization age, size, growth rate, and focal tasks or challenges faced by the firm while common structural dimensions including structural form, formalization, centralization, and vertical differentiations, the number of organizations levels.

Through how many life-cycle stages do organizations grow? Most of the existing organizational life-cycle models are multi-stage in nature, varying broadly from three (Smith, Mitchell, and Summer, 1985) to ten (Adizes, 1989) stages. Hanks, Watson,

Jensen & Chandler (1993) had presented a good summary of existing life models, noting that a comparison of stage content reveals a fairly consistent pattern of organization evolution. Miller and Friesen (1984) contended that organizations tend to move in a linear sequence of five stages: birth, growth, maturity, revival, and decline. They, however, argued that organizations by no means go through the stage in the same sequence. Lester, Parnell & Carraher (2003) found that models with more stages appear to break down general stages to rather specific periods. By contrast, model with fewer, broader stages integrate two or more developmental periods because of parsimony.

The business life-cycle model in this study aims to be designed for for-profit firms in the new economy rather than relevant for all organizations. Most of the organizational life cycle researches are not designed for not-for-profit organizations. However, the term “organizational life cycles” should include the life cycles of not-for-profit organizations. There is no existing research trying to answer questions about the differences of life cycles between for-profit and not-for-profit organizations. Therefore, the author uses *business life cycles* to define the scope of organizational developmental process.

### FIVE ELEMENTS THEORY AND BUSINESS FUNCTIONS

The five elements theory formed the fundamental basis of systems thinking of the ancient Chinese. The five elements theory is one of the Chinese worldviews and methodologies which most of the Chinese scholars have recognized over the past millennia. Viewing the universe as revolving around the five basic elements of everyday life—Wood, Fire, Earth, Metal, and Water (Figure 1), the ancient Chinese believe that everything in the universe is derived from the movements and changes of the five elements. The theory of the five elements generalizes all matters in the universe. All objects and phenomena are classified into five large categories through the use of analogies. These five elements have been used to represent and explain various phenomena of the empirical world.

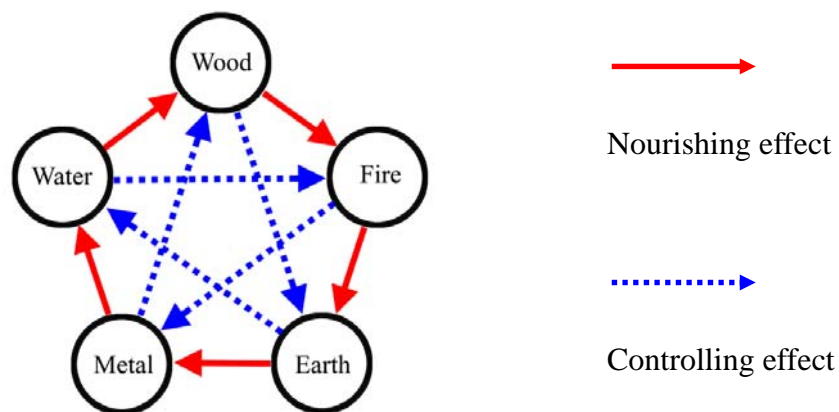


Figure 1. The five elements model

The main contributions of the five elements theory begin with the notion of nourishing and controlling cycles (see Figure 1). The ancient Chinese had developed a method for describing the dynamic relationship between elements, which is embodied by two complimentary and opposite cycles: the nourishing and controlling cycles. The five-element model can maintain its internal harmony through the mutual reinforcements and checks generated from these two cycles. The nourishing effect implies the influence of breeding, incubation, or facilitation, whereas the controlling effect suggests the forces of constraint, questioning, or reform between the elements.

Business functions could be analogically classified in terms of the five elements. Wang (2002) has endeavored to assign the business functions to the five elements by analogy: the research and development function as Wood, the marketing function as Fire, the operations and human resources functions as Earth, the financial, accounting and purchasing functions as Metal, and the innovation as well as information functions as Water.

The interactions of business functions could also be represented by the nourishing and controlling effects. There are five nourishing and five controlling effects in the five elements model. The nourishing effects illustrated in terms of business functions revolve around how one business function facilitates or improves another. By comparison, the controlling effects center on its positive side: how one business function effectively transform or forge another.

There are three interactions of business functions that are important to analyze business life cycles in the new economy and could be represented by the Water-Fire, Fire-Metal, and Earth-Water effects. The Water-Fire effect stands for the profitable and sustainable vision created by the interaction of the innovation and marketing functions. Effective innovation always takes place under the controlling effect of Water on Fire. Water means a firm's *internal change* in the manner of innovation; whereas Fire signifies the *external change* in the environment, in particular the variation in customers' needs and competition. How could a firm syncretize these two changes to find a win-win solution? Barwise and Meehan (2004) suggest that it could deliver customer-focused differentiation — differentiation that matters to customers. To fight for survival in the global market, a company needs to call on its innovation function (Water) to cope effectively with the changes in the customers' needs (Fire).

The Fire-Metal effect depicts a firm's competitiveness resulting from the controlling effect of the marketing function on the financial, accounting and purchasing functions. Financial managers must ensure that it always has enough funds on hand to purchase the materials and adequate human resources that it needs to produce goods and provide services. The funds that the financial function (Metal) needs would be restricted by sales revenues that the marketing function (Fire) generates. Therefore, the financial function should control or regulate the expenditure in terms of the income from sales. In addition, a positive controlling effect of Fire on Metal could be represented by benchmarking. Benchmarking is a process of comparing a company's performance with that of others, identifying comparatively well-performing organizations, and learning what they do that allows them to achieve a high level of performance. Accordingly, the Fire-Meta effect could measure a firm's competitiveness relative to its competitors.

The Earth-Water effect would reflect the organizational learning and innovative capabilities, the outcome of the interaction of the operations and innovation functions. Innovation is largely comprised of abstract activities. The realization of the innovation

(Water) is always influenced by a firm's operations capability (Earth). The controlling effect of Earth on Water highlights the organizational learning effect that will lead to workable innovation. It means that incorporating the valuable lessons learned in the operations function or execution (Earth) into the corporate culture or the theory of business (Water), the seed of innovation. The fundamental assumption of corporate culture and the mindset of the top management in Water are examined and questioned by the capability of execution of the operations function (Earth). Consequently, the effect of Earth on Water can be represented by organizational learning, in which Water is examined and questioned by Earth to decide whether and what experience or knowledge applied in the operations function can be extracted for the next innovation.

To investigate the business life cycles in the new economy necessitates a workable but simple model derived from the five elements theory. The Water-Fire effect and the basic triangle (see Figure 2 & 3), comprised of the R & D, operations and financial functions, could serve this purpose. The Wood-Earth-Metal represents the focus of traditional management. Essentially, it refers to the R&D-Operations-Financing functions, which emphasize how to manufacture products or provide services more effectively and efficiently. By contrast, the Water-Fire effect stands for the trend of modern business in the new economy. It highlights the modern business appeal for innovation and marketing, which centers on the topic of how to provide effective solution to customers, that is, a manifestation of customer-orientation.

However, the corporate performance depends on the integration of the Water-Fire effect and the basic triangle. In fact, the **emerging property** has characterized the performance of any firm. Therefore, to deliver superior performance one cannot do without managing both the Water-Fire effect and the basic triangle. Specifically, the Water-Fire effect aims to create profitable orders through innovation and differentiation. It triggers the operation of the R&D-Operations-Financing functions and sets a competitive goal for a firm to achieve.

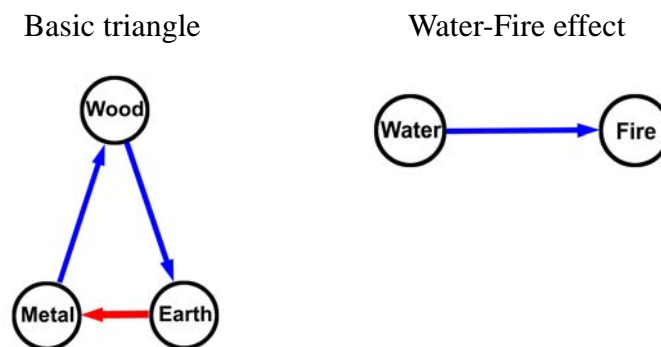


Figure 2. Basic triangle and Water-Fire effect

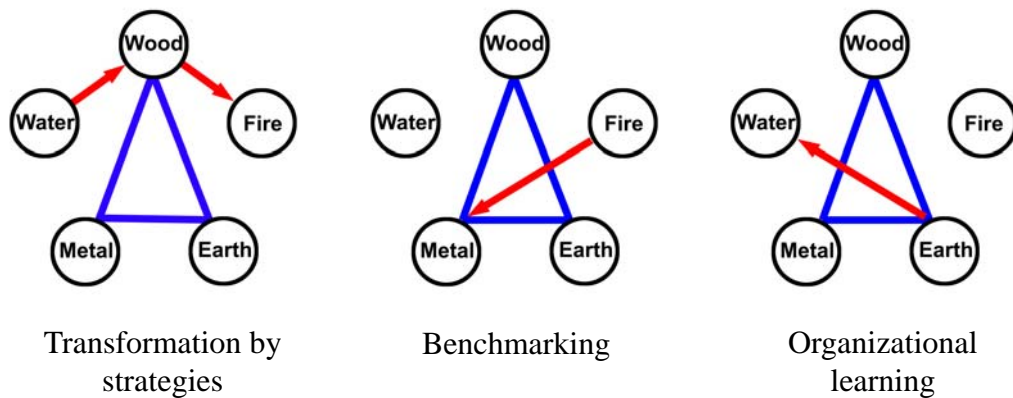


Figure 3. Interactions between basic triangle and Water-Fire effect

### BUSINESS LIFE CYCLES AND FIVE ELEMENTS INTERACTIONS

This study tries to offer a conceivable business life cycle (see Figure 4 & 5), able to be verified by executives as reflecting their experience. The organizational life-cycle literature has suggested that organizations evolve in a consistent and predictable manner. The author attempts to explore the development of for-profit organizations in terms of business functions' interactions and adopts the five stage model proposed by Lester, Parnell & Carraher (2003). The selection of five stages in this study was made in the interest of parsimony and ease of comparison. In fact, as illustrated in Figure 4 and Table 1, there are eleven sub-stages in terms of three five-element interactions. Therefore, the author believes that this model is able to both present a clear outline of a firm's growth path and provide a sound explanation of its development.

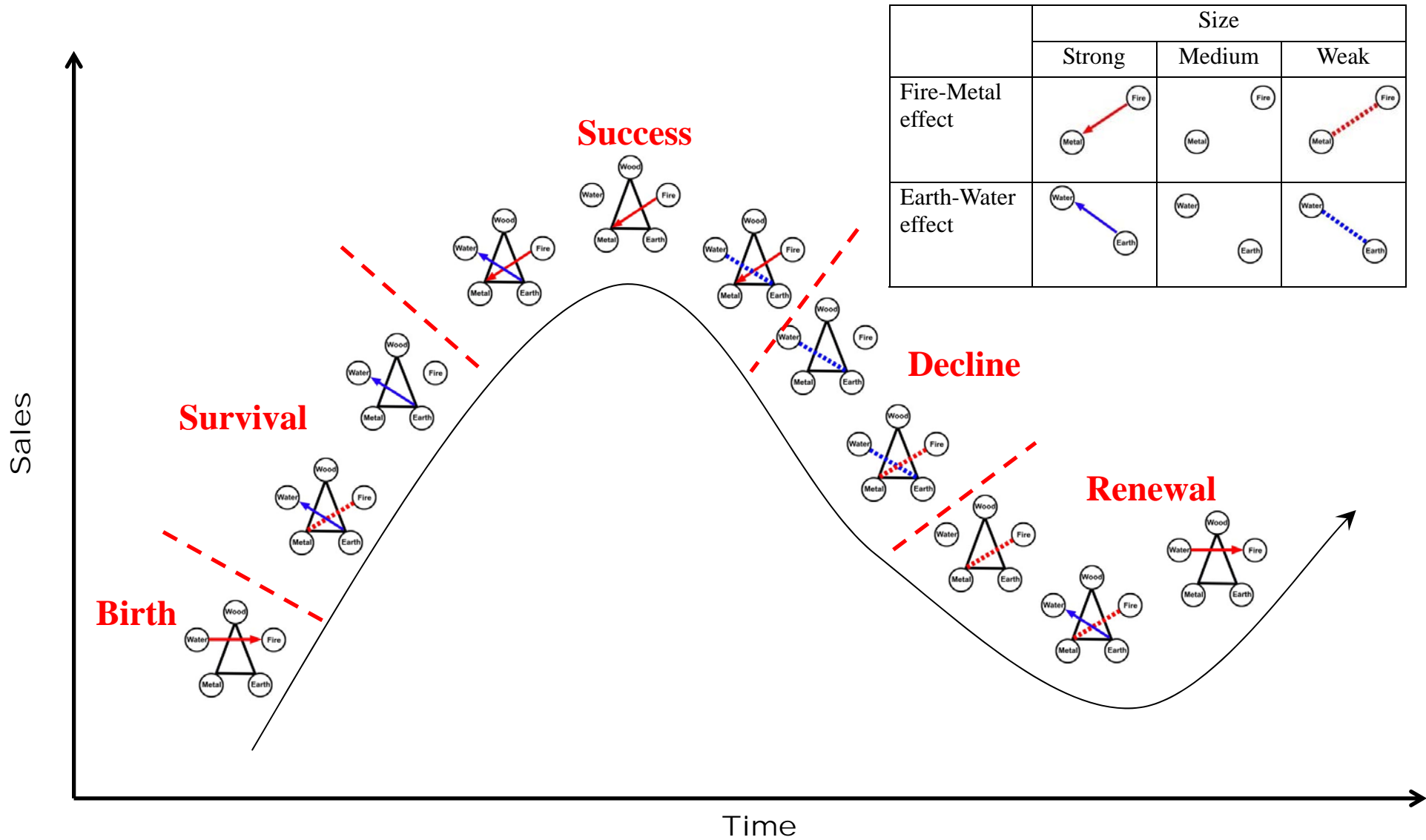


Figure 4. Business Life Cycle in Terms of Five-element Model

Table 1. Characteristics of business life cycle in terms of five-element interactions

| Stage      | Corresponding Figures | Water-Fire effect<br>(New Vision) | Fire-Metal effect<br>(Competitiveness) | Earth-Water effect<br>(Organization learning and innovation) |
|------------|-----------------------|-----------------------------------|--|--|
| Birth      |                       | Strong                            |  |  |
| Survival 1 |                       |                                   | Weak                                   | Strong   |
| Survival 2 |                       |                                   | Medium                                 | Strong   |
| Success 1  |                       |                                   | Strong                                 | Strong   |
| Success 2  |                       |                                   | Strong                                 | Medium   |
| Success 3  |                       |                                   | Strong                                 | Weak   |
| Decline 1  |                       |                                   | Medium                                 | Weak   |



Table 1. continued

|              |  |        |      |        |
|--------------|--|--------|------|--------|
| Decline<br>2 |  |        | Weak | Weak   |
| Renewal<br>1 |  |        | Weak | Medium |
| Renewal<br>2 |  |        | Weak | Strong |
| Renewal<br>3 |  | Strong |      |        |

|                    | Size   |        |      |
|--------------------|--------|--------|------|
|                    | Strong | Medium | Weak |
| Fire-Metal effect  |        |        |      |
| Earth-Water effect |        |        |      |

### **Birth stage**

The primary purpose and activity of a firm at the birth stage is to set the direction of corporate development for the foreseeable future. To fight for survival in the global market, the firm need to call on its innovation function (Water) to cope effectively with the changes in the customers' needs (Fire). The focus is on how to provide effective solutions to customers. Organizations in this stage tend to formulate a profit-oriented and sustainable direction. It is the result of the interaction between innovation and marketing functions, the mirror of the Water-Fire effect. Specifically, the Water-Fire effect aims to create profitable orders through differentiation – the very essence of innovation. It could be realized through the tradition triangle, strategy – R & D, production, and financing functions.

### **Survival stage**

The survival stage is characterized by the strong organizational learning effect and increasing competitiveness. This stage involves increased production, new recruitment, and the development of strong brands through focused marketing activities. Companies continuously devote most of their time and money to R & D as well as production activities at this phase to enrich and deepen their organizational learning experience. This is the manifestation of the Earth-Water effect, as a result of which a firm consolidates its valuable experience of operations into its corporate culture or the theory of business. As firms move through the survival stage, the fundamental assumption of corporate culture and the mindset of the top management (Water) are continuously examined, questioned, and modified by the capability of execution of the operations function (Earth). Consequently, firms could increasingly enhance their competitiveness by cost reduction through the effect of learning curves.

The satisfactory interaction of the stable Earth-Water effect and the increasing Fire-Metal effect eventually grows into a key success factor of the next stage. The stable Earth-Water effect that endorses the organizational learning would last until the early period of the success stage. In addition, the increasingly improved Fire-Metal effect would mature into a firm's core competency that ensures its competitiveness at the next stage. The interaction of the Earth-Water and Fire-Metal effects contributes to the high performance corporate culture and abundant innovation capabilities at the survival stage and finally develops into a key success factor of the success stage.

### **Success stage**

As firms move through the success stage, they enjoy superior financial performance relative to competitors but face declining learning capabilities. They always get profitable orders and turn in a high level performance throughout this stage. A strong Fire-Metal effect could unfold this success story.

However, why are some successful companies unable to sustain their growth? One plausible answer might rest on their worsening learning abilities. This would account for the myth why (or the turning point when) some firms' growth deteriorates after the success stage. The weakening of learning capabilities (the Earth-Water effect) would continue to exit and lead to the decline stage. It also explains why firms at the success stage always sow the seeds of failure. Sull (2003, p. 44-45) argued that superior financial performance relative to competitors would result in a sense of satisfaction with the status quo and slacken managers' motivation to change. Moreover, superior performance would enhance their confidence that they have found an effective formula for competing.

In fact, the best time for refreshing organization learning arrives near the end of the success stage. Before firms stumble into the decline stage, they would become aware the problem of the deteriorating corporate-wide learning abilities but still benefit from steady orders. Actually, there is a best option of the moment for these firms to utilize their slack resources to rebuild their learning capabilities. If a firm could revitalize the corporate learning before the end of the success stage, it would prevent itself from falling into the decline.

### **Decline stage**

The downfall of the organizational learning abilities and deteriorating profit and loss of market share outline the problems of the corporation at the decline stage. As firms suffer from the declining performance, they always face external problems such as the emergence of new competitors, fierce competition, falling prices. In addition, internal issues like overstaff, increasing expenses, and exhausted innovation might dull their motivation to stay in the industry.

The declining phase may trigger the reflection of managers on launching the transformative change at corporate level. The lack of profit and loss of market share would be likely to provoke the demise of the firms unless they are determined to fight for their survival through transformative changes.

### **Renewal stage**

The renewing firms always experience three processes of change: unfreezing, learning, and refreezing. Evolutionary learning and change goes on all the time. Organizations are dynamic systems interacting with constantly changing environments. The process of change always starts with some form of survival anxiety (Schein, 1999, p. 115-127). The decayed competitiveness, stemming from the weak Fire-Metal effect, has posed a direct threat to a firm's existence. It forces a firm to break the spell of its past success formula and commit itself to new and effective organization learning.

The companies endeavor to develop their learning capabilities after they have unlearned something that worked well in the past. They attempted to relearn to do the right things faster, better, and more productively than their competitors. The organizational learning abilities are likely to stopped declining; however, their corporate performance would still be inferior to their competitors' and the decayed competitiveness continues.

The final step in the renewal stage is to rebuild a new sustainable direction. Miller and Friesen (1984, p. 1177) argued that periods of birth and revival are accompanied by a bold, innovative, organic orientation. Organizations have to invent and internalize the new concepts leading to the high performance behaviors before the end of the transformative change process. The relearning efforts have effectively fertilized firms' capabilities to manage the next ideal future business.

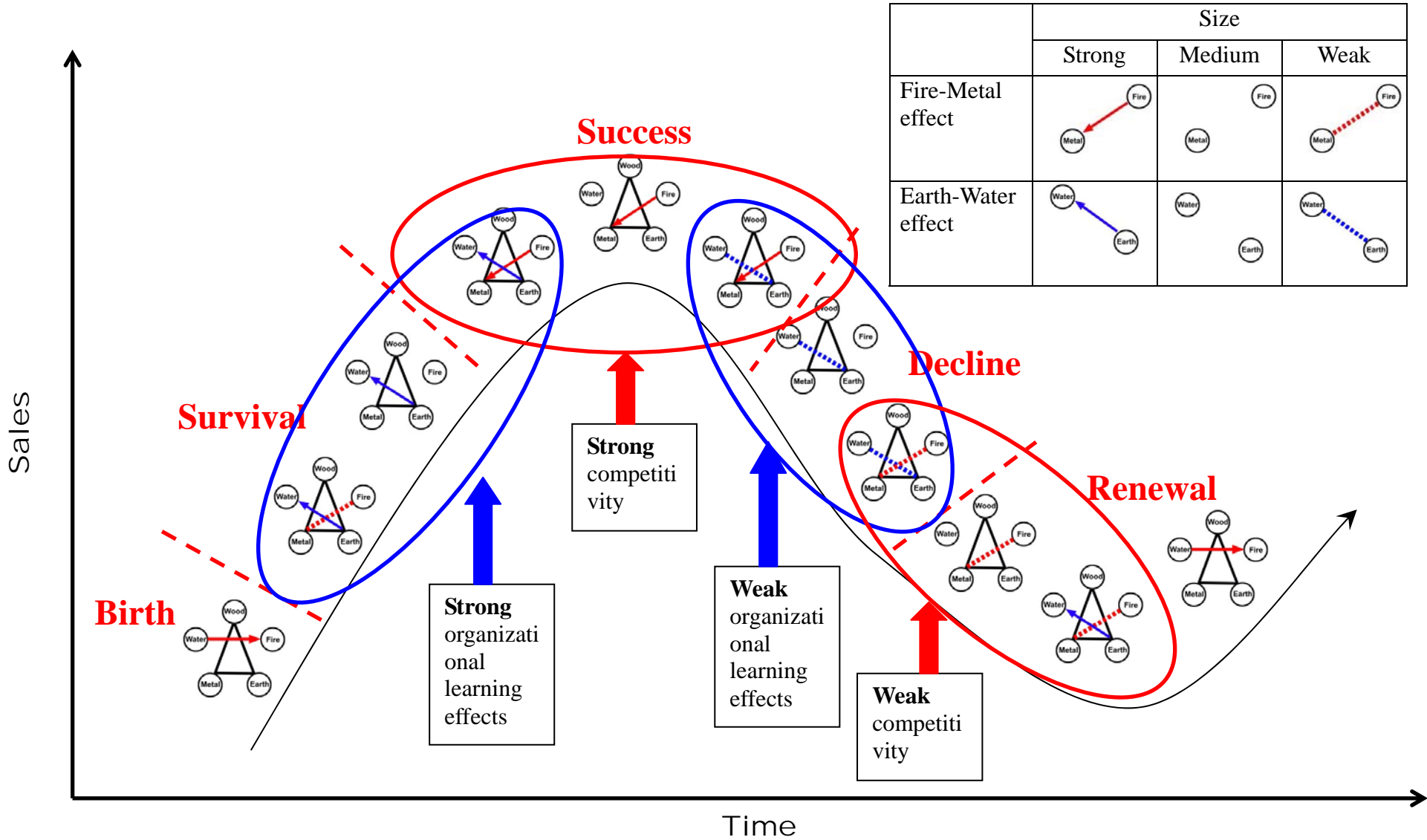


Figure 5. Overlaps between stages of business life cycle

## CONTRIBUTION OF THIS RESEARCH

1. **Establish a link between the stages of the business life cycles and the business functions.** Business functions are the primary activities and tasks for a corporation to achieve success or performance. This study utilizes the business functions that are closely related to corporate performances to depict the characteristics of the business life cycle. Therefore, the rise and fall of business performance could be easily demonstrated.
2. **Explore the business development from the holistic interactions of business functions, using the systems thinking approach.** The business performance is an emergent property of a firm that is a product of the interactions among the various functions or activities. This research has successfully unfolded how corporate performance evolves over time in terms of the interactions of business functions.
3. **It could be inferred from this study that the stages of the business life cycle are interdependent and continuous (see Figure 5).** The evolution from one stage to another could be clarified by the rise and fall of the Fire-Metal and Earth-Water effects. From the survival to the success stage, the organizational learning effect (the Earth-Water effect) is a crucial factor in successfully surviving the challenge to its entering the industry. Moreover, the organization learning capability would be further enhanced till the first phase of the success stage. A firm could benefit greatly from the previous organizational learning effect and remain competitive at the success stage. However, it might neglect its further effort or investment in deepening or refreshing the organizational learning that is directly related to the innovation capability. Therefore, we could find companies always suffering from their inadequate learning abilities from the later part of the success stage to the decline stage. Finally, a firm would endure poor competitiveness from the later phase of the decline stage to the renewal stage. Nevertheless, the very challenge would trigger firms' motivation to implement transformative changes.
4. **Corporate changes are logically incorporated into the business life cycle.** A firm could carry out changes at some stage of the business life cycle. This study proposes that the renewal stage evolves naturally from the decline phase and is suitable for the corporate changes. The appropriate time and condition for firms to launch changes is identified by the interaction of the Fire-Metal and Earth-Water effects. Additionally, the author has established a reasonable link between three phases of the corporate change and the five elements theory.

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