PART 1: STRATEGIC MANAGEMENT INPUTS

CHAPTER 3
THE INTERNAL ENVIRONMENT: RESOURCES, CAPABILITIES, & CORE COMPETENCIES

Internal Analyses’ Outcomes

By studying the internal environment, firms identify what they CAN DO

Unique Resources, Capabilities, and Competencies (required for sustainable competitive advantage)

Strategic Competitiveness and Above-Average Returns Result When:

• What a firm can do:
  • Function of resources, capabilities, and core competencies

• What a firm might do:
  • Function of opportunities in the firm’s external environment

Competitive Advantage Key Points

• No competitive advantage lasts forever
• Over time, rivals use their own unique resources, capabilities, and core competencies to duplicate the focal firm’s ability to create value for customers
• With globalization, sustainable competitive advantage is especially challenging

Competitive Advantage Key Points

• Firms must exploit their current advantages while simultaneously using their resources and capabilities to form new advantages that can lead to future competitive success
• Innovation and people are critical resources for organizations in their quest for competitive advantage
COMPETITIVE ADVANTAGE

SUSTAINABILITY

Sustainability of a competitive advantage is a function of:

- The rate of core competence obsolescence due to environmental changes
- The availability of substitutes for the core competence
- The imitability of the core competence

COMPETITIVE ADVANTAGE

Components of Internal Analysis Leading to Competitive Advantage and Strategic Competitiveness

FIGURE 3.1
Components of an Internal Analysis

ANALYZING THE INTERNAL ORGANIZATION

Creating Value

By innovatively bundling and leveraging their resources and capabilities, by exploiting their core competencies or competitive advantages, firms create value.

Value is measured by:

- Product performance characteristics
- Product attributes for which customers are willing to pay

Superior value → Above-average returns

RESOURCES, CAPABILITIES, AND CORE COMPETENCIES

RESOURCES

- Are the source of a firm’s capabilities
- Are broad in scope
- Cover a spectrum of individual, social, and organizational phenomena
- Represent inputs into a firm’s production process
- Alone, do not yield a competitive advantage, i.e., by themselves do not allow firms to create value that results in above-average returns

CORE COMPETENCIES

- Resources
  - Tangible
  - Intangible

CAPABILITIES

TYPES OF RESOURCES

Tangible Resources

- Assets that can be seen, touched, and quantified

Intangible Resources

- Assets rooted deeply in the firm’s history, accumulated over time
- In comparison to ‘tangible’ resources, usually can’t be seen or touched

Compared to tangible resources, intangible resources are a superior source of core competencies
RESOURCES, CAPABILITIES, AND CORE COMPETENCIES

TYPES OF RESOURCES

Tangible Resources
- FINANCIAL RESOURCES - the firm’s capacity to borrow and generate internal funds
- ORGANIZATIONAL RESOURCES - formal reporting structures
- PHYSICAL RESOURCES - sophistication and location of a firm’s plant and equipment; distribution facilities; product inventory
- TECHNOLOGICAL RESOURCES - stock of technology, such as patents, trademarks, copyrights, and trade secrets

Intangible Resources
- HUMAN RESOURCES - knowledge; trust; skills; collaborative abilities
- INNOVATION RESOURCES - scientific capabilities; capacity to innovate
- REPUTATIONAL RESOURCES - brand name; perceptions of product quality, durability, and reliability; positive reputation with stakeholders, e.g., suppliers/customers

CAPABILITIES

- Emerge over time through complex interactions among tangible and intangible resources
- Stem from employees
  - Unique skills and knowledge
  - Functional expertise
- Are activities that a firm performs exceptionally well relative to rivals
- Are activities through which the firm adds unique value to its goods or services over an extended period of time

Core Competencies
- Exist when resources have been purposely integrated to achieve a specific task or set of tasks
- Are often developed in specific functional areas
  - Distribution
  - Human resources
  - Management information systems
  - Marketing
  - Management
  - Manufacturing
  - Research & Development

RESOURCES, CAPABILITIES, AND CORE COMPETENCIES

TABLE 3.3 Examples of Firms’ Capabilities

<table>
<thead>
<tr>
<th>Functional Area</th>
<th>Capabilities</th>
<th>Examples of Firms</th>
</tr>
</thead>
</table>
| Marketing       | • Influence promotion of brand name products  
                  • Effective promotion of products in specific sectors  
                  • Increased brand awareness  
| Management      | • Ability to sense the future of business  
                  • Effectively plan and control  
                  • Strategic planning  
| Manufacturing   | • Design and production skills for developing reliable, high-quality industrial products  
                  • Effectively plan and control  
                  • Strategic planning  
| Research & Development | • Innovation technology  
                        • Commercialization of research and development  
                        • Rapid transformation of technology into new products  

BUILDING CORE COMPETENCIES

TWO TOOLS FIRMS USE TO IDENTIFY AND BUILD CORE COMPETENCIES:

- **Four Specific Criteria** of Sustainable Competitive Advantage that can be used to determine which capabilities are core competencies
- **Value Chain Analysis** - this tool helps select the value-creating competencies that should be maintained, upgraded, or developed and those that should be outsourced
BUILDING CORE COMPETENCIES

The Four Criteria of Sustainable Competitive Advantage

Capabilities must fulfill four specific criteria in order to be core competencies:

1. Valuable
2. Rare
3. Costly-to-imitate
4. Nonsubstitutable capabilities

TABLE 3.5
Outcomes from Combinations of the Criteria for Sustainable Competitive Advantage

<table>
<thead>
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TABLE 3.6
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VALUE CHAIN ANALYSIS

- Allows the firm to understand the parts of its operations that create value and those that do not
- A template that firms use to:
  - Understand their cost position
  - Facilitate the implementation of a chosen business-level strategy

VALUE CHAIN ACTIVITIES:

- Activities the firm completes in order to produce products and then sell, distribute, and service those products in ways that create value for customers

VALUE CHAIN ACTIVITIES:

- Activities the firm completes in order to support the work being done to produce, sell, distribute, and service the products the firm is producing

To become a core competence and a source of competitive advantage, a capability must allow the firm:

1. to perform an activity in a manner that provides superior value relative to competitors, or
2. to perform a value-creating activity that competitors cannot perform
BUILDING CORE COMPETENCIES

Figure 3.3: A Model of the Value Chain

- Supply Chain Management
- Operations
- Distribution
- Marketing/Inventing
- Customer Service


Figure 3.4: Creating Value Through Value Chain Activities

- Apple
- Dell
- IBM
- Microsoft
- TSMC
- Samsung
- LG
- Sony
- Toshiba
- Sharp


Figure 3.5: Creating Value through Support Functions

- Marketing/Inventing
- Operations
- Distribution
- Support Functions


VALUE CHAIN ANALYSIS

- SOCIAL CAPITAL: when firms have strong positive alliances with suppliers and customers
- TRUST: is required to build social capital whereby resources such as knowledge are transferred across organizations
- JUDGMENT: pivotal in evaluating a firm’s capability to execute its value chain activities and support functions

OUTSOURCING

- Definition: purchase of a value-creating activity or support function from an external supplier
- Effective execution includes an increase in flexibility and risk mitigation, and a reduction in capital investment
- Global industries trend continues at a rapid pace
- Firms must outsource activities where they cannot create value or are at a substantial disadvantage compared to competitors

STRATEGIC RATIONALES

- Few organizations are competitively superior in all value chain activities and support functions
- By outsourcing activities where it lacks competence, the firm can fully concentrate on those areas in which it can create value
- Freeing resources for other purposes redirects efforts from non-core activities toward those that serve customers more effectively
OUTSOURCING

STRATEGIC RATIONALES

- Specialty suppliers can perform outsourced capabilities more efficiently.
- Sharing risks - reduces investment requirements and makes firm more flexible, dynamic, and better able to adapt to changing opportunities.
- Providing access to world-class standards - the specialized resources of outsourcing providers makes world-class capabilities available to firms.

OUTSOURCING

- Outsource those value chain activities and support functions that are NOT a source of core competence.
- Concerns: innovation, technological uncertainty, and job loss; usually revolves around firm's innovative ability and loss of jobs to external supplier.
- Offshoring - foreign supply source.

COMPETENCIES, STRENGTHS, WEAKNESSES, AND STRATEGIC DECISIONS

- Firms must identify their strengths and weaknesses.
- Appropriate resources and capabilities are needed to develop desired strategy and create value for customers and other stakeholders.

COMPETENCIES, STRENGTHS, WEAKNESSES, AND STRATEGIC DECISIONS

- The "right" resources (as opposed to "many" resources) are those with the potential to be formed into core competencies as the foundation for competitive advantage.
- Tools (e.g., outsourcing) can help a firm focus on core competencies as the source for competitive advantage.

COMPETENCIES, STRENGTHS, WEAKNESSES, AND STRATEGIC DECISIONS

- Core competencies have potential to become CORE RIGIDITIES.
- Former core competencies that now generate inertia and stifle innovation.
- External environmental conditions and events impact a firm's core competencies.

COMPETENCIES, STRENGTHS, WEAKNESSES, AND STRATEGIC DECISIONS

- What a firm can do:
  - Function of resources, capabilities, and core competencies
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  - Function of opportunities in the firm's external environment.