

The Internal Environment: Resources, Capabilities, and Core Competencies

Chapter Four

second canadian edition

Strategic Management

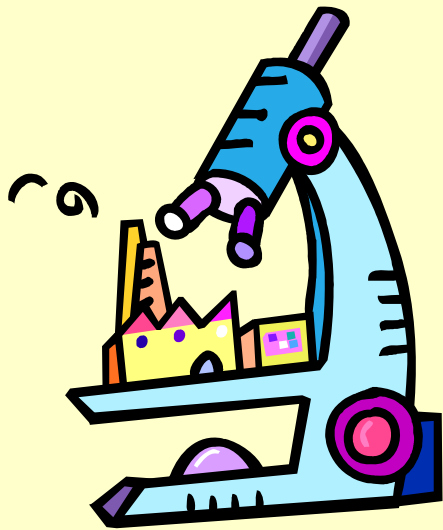
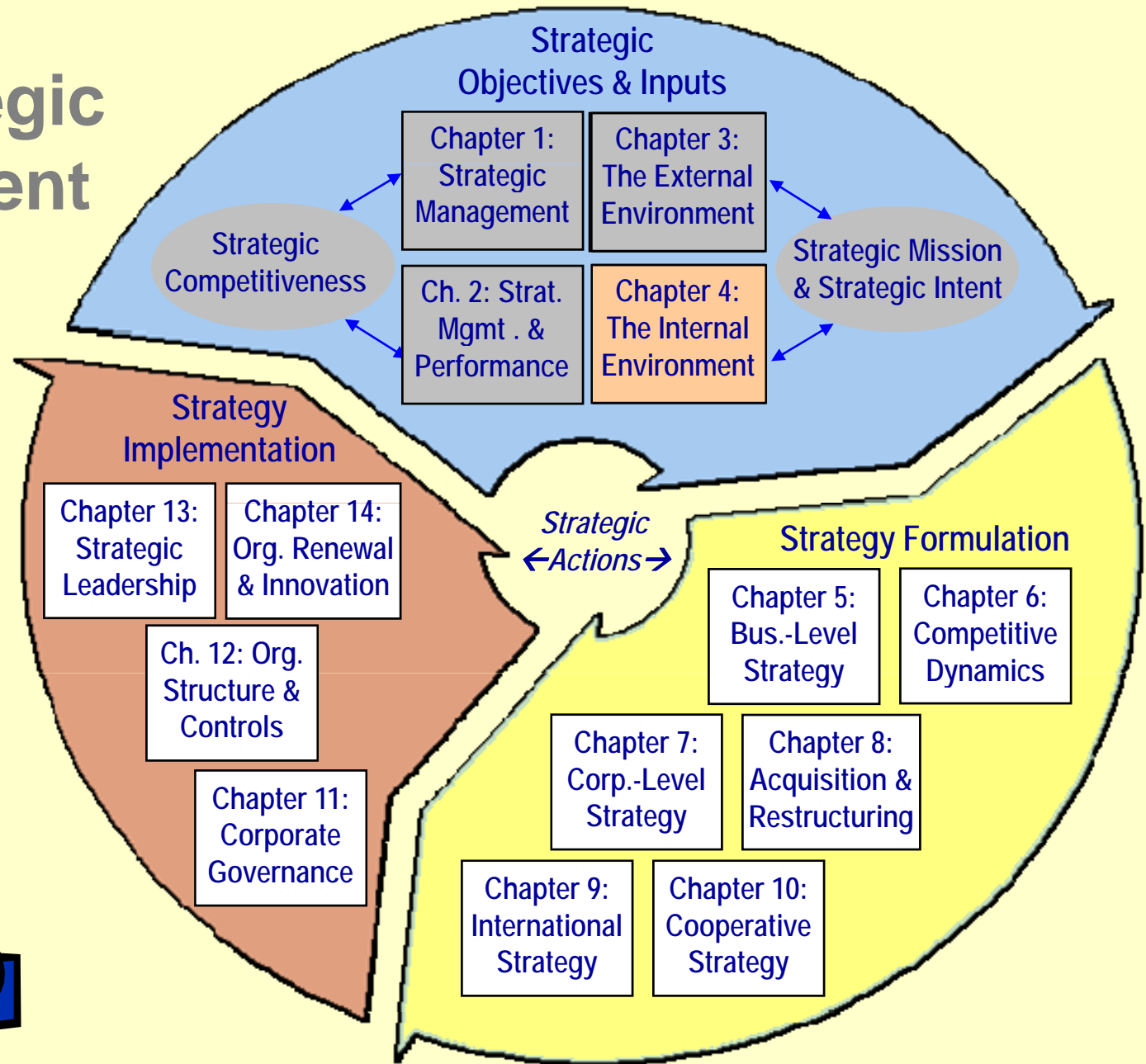
Competitiveness and Globalization

CONCEPTS

Hitt
Ireland
Hoskisson
Rowe
Sheppard

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The Strategic Management Process



The Internal Environment: Resources, Capabilities and Core Competencies

Knowledge Objectives:

1. Explain the need for firms to study & understand their internal environment.
2. Define value & discuss its importance.
3. Learn how tangible & intangible resources differ.
4. Define capabilities & discuss how they are developed.
5. Describe four criteria used to determine whether resources & capabilities are core competencies.
6. Explain how value chain analysis is used to identify and evaluate resources and capabilities.
7. Define outsourcing & discuss the reasons for its use.
8. Discuss the importance of preventing core competencies from becoming core rigidities.

Canada's most Admired Companies

2003 Top Ten	2002 Top Ten	2001 Top Ten
1. RBC Financial	1. RBC Financial	1. Bombardier Inc.
2. WestJet	2. Bombardier Inc.	2. RBC Financial
3. BCE Inc.	3. BCE Inc.	3. BCE Inc.
4. Loblaw Companies	4. Magna International	4. Nortel
5. Bombardier Inc.	5. Loblaw Companies	5. Toronto Dominion Bank
6. Research in Motion	6. Dofasco	6. Research in Motion
7. Bank of Nova Scotia	7. WestJet	7. Loblaw Companies
8. EnCana Corporation	8. Research in Motion	8. Magna International
9. BMO Financial	9. TD Canada Trust	9. Power Corporation
10. Magna International	10. IBM Canada	10. Canadian Imperial Bank

The Resource-Based model of Above Average Returns

- Capabilities evolve and must be managed dynamically in pursuit of above-average returns.
- Firms acquire different resources and develop unique capabilities. These resources may not be mobile across firms and that the differences in resources are the basis of competitive advantage.

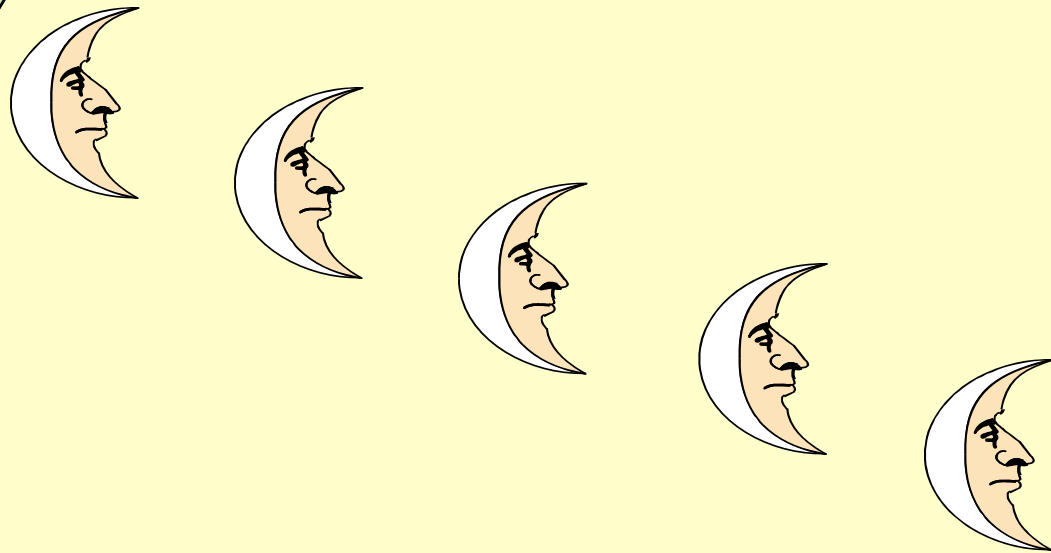
The Resource-Based model of Above Average Returns

The resource based view suggests that a firm's unique resources and capabilities provide the basis for a strategy.

The **Resource-Based** Model of Superior Returns

Resources

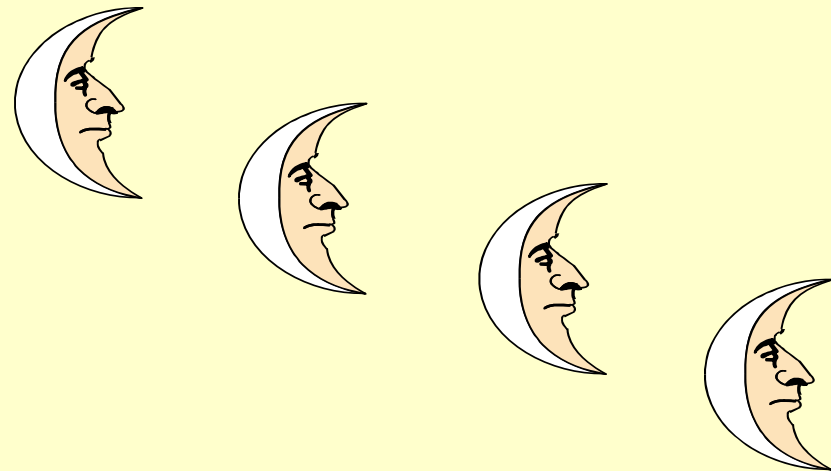
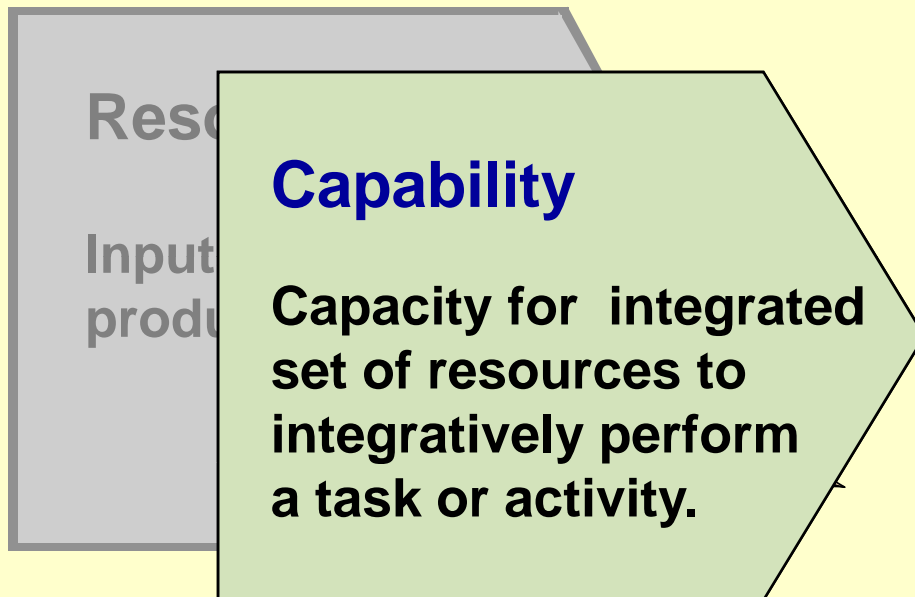
**Inputs to a firm's
production process.**



Action required:
Identify firm resources.
Study strengths &
weaknesses relative to
rivals.

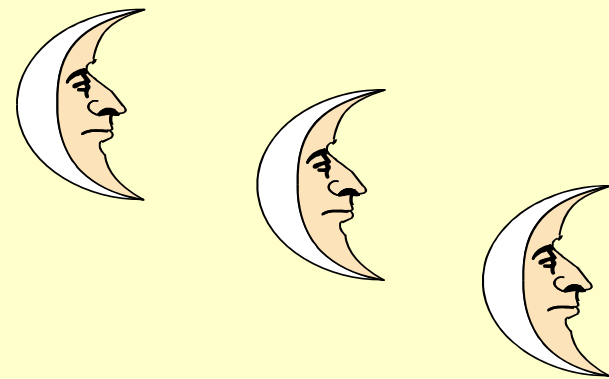
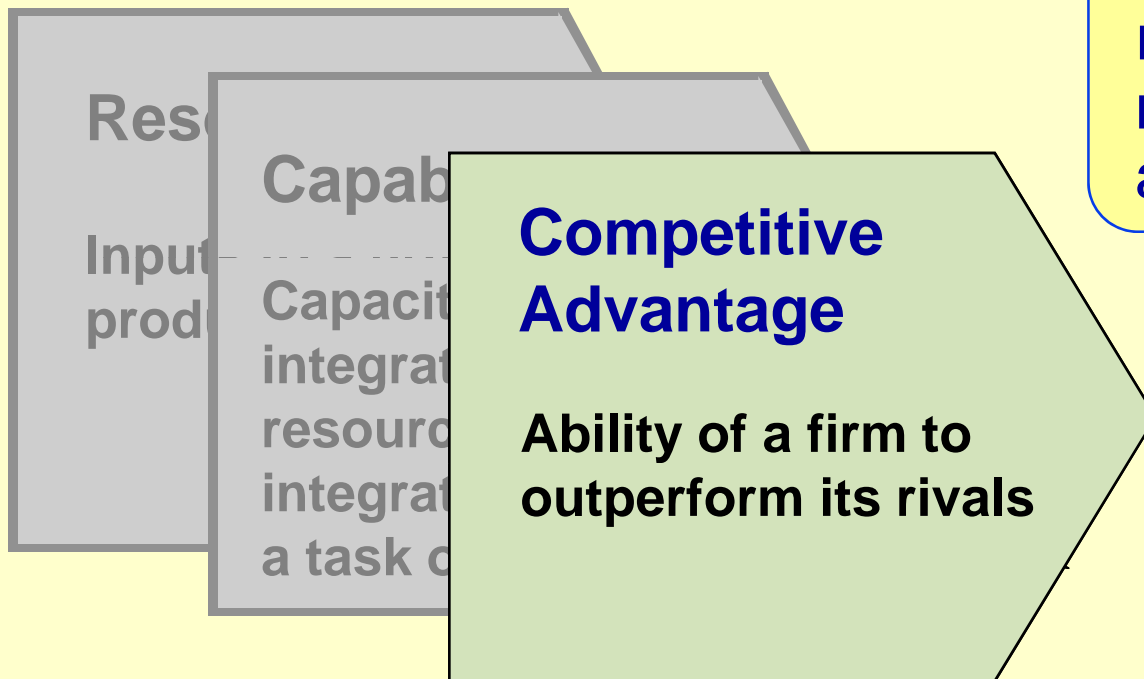
The Resource-Based Model of Superior Returns

Action required:
Determine what firm capabilities allow it to do better than rivals.



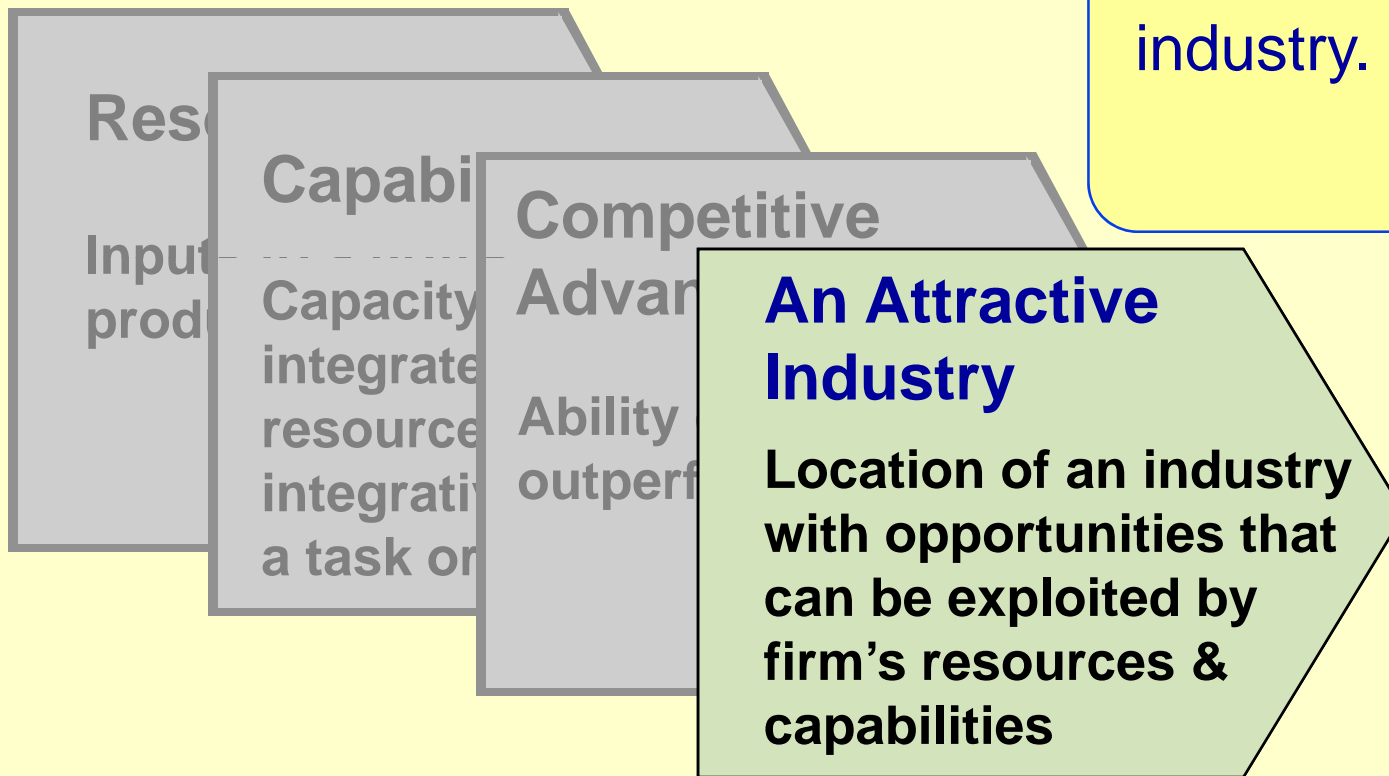
The Resource-Based Model of Superior Returns

Action required:
Determine how firm's resources & capabilities may create competitive advantage.



The **Resource-Based** Model of Superior Returns

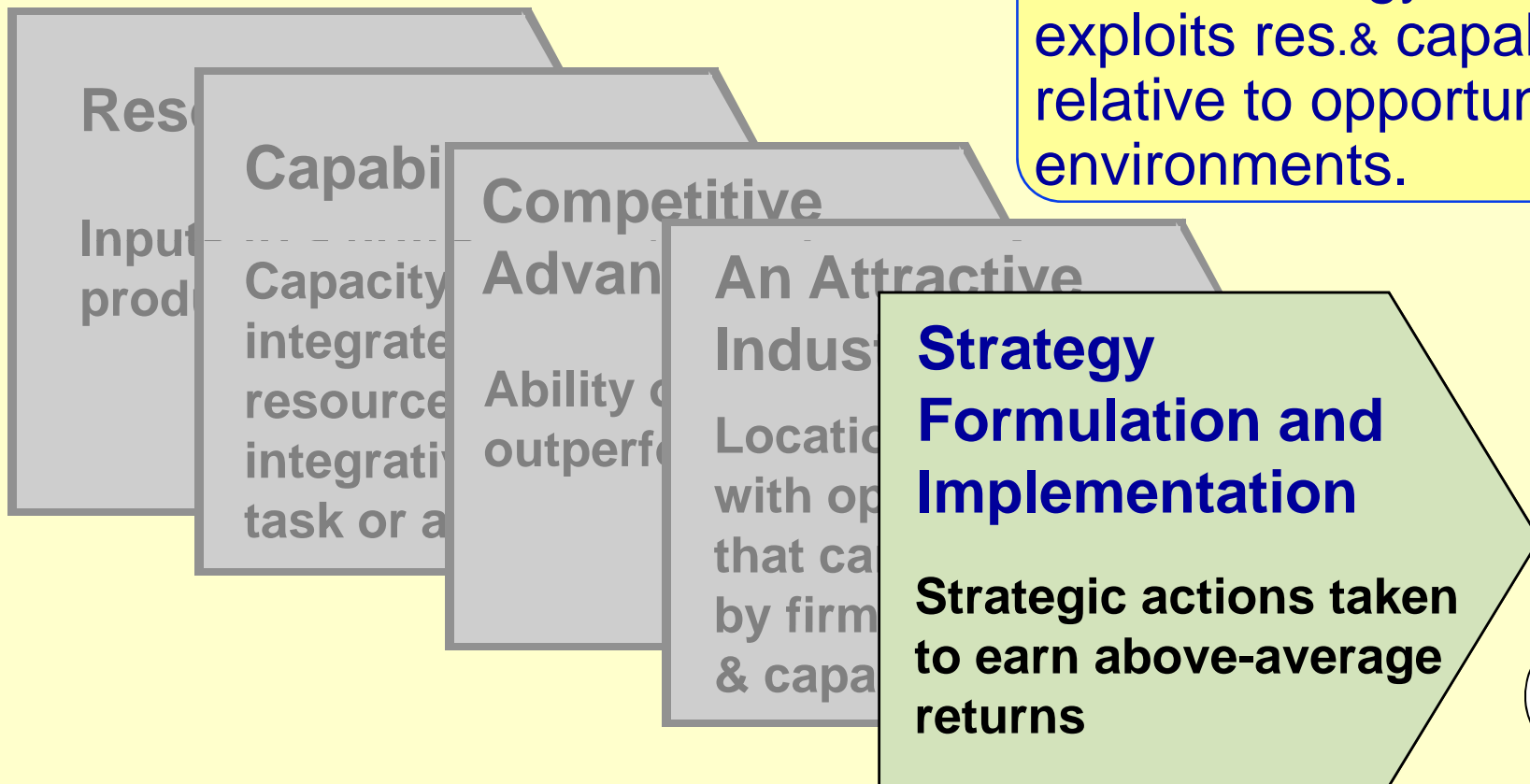
Action required:
Locate an attractive industry.



The Resource-Based Model of Superior Returns

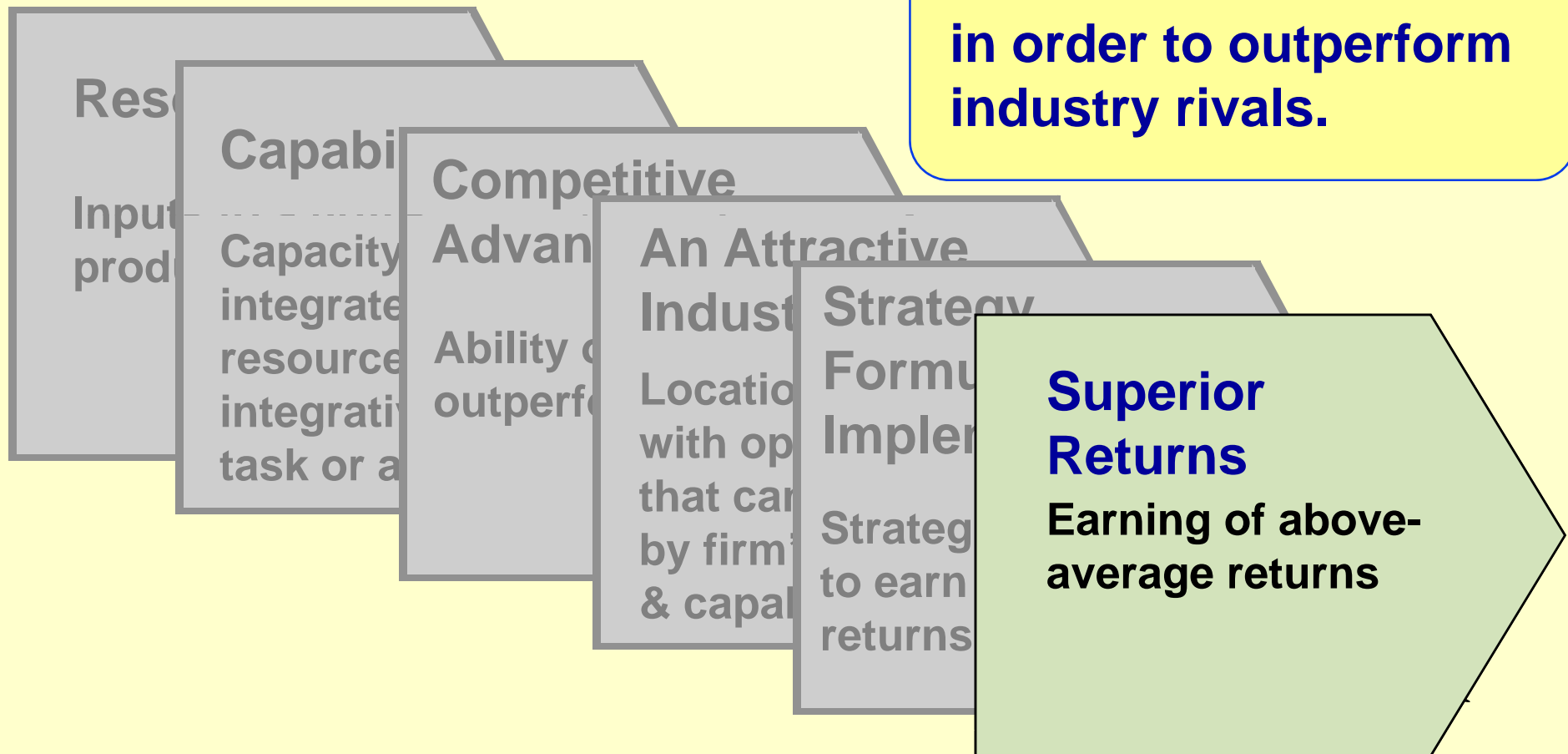
Action required:

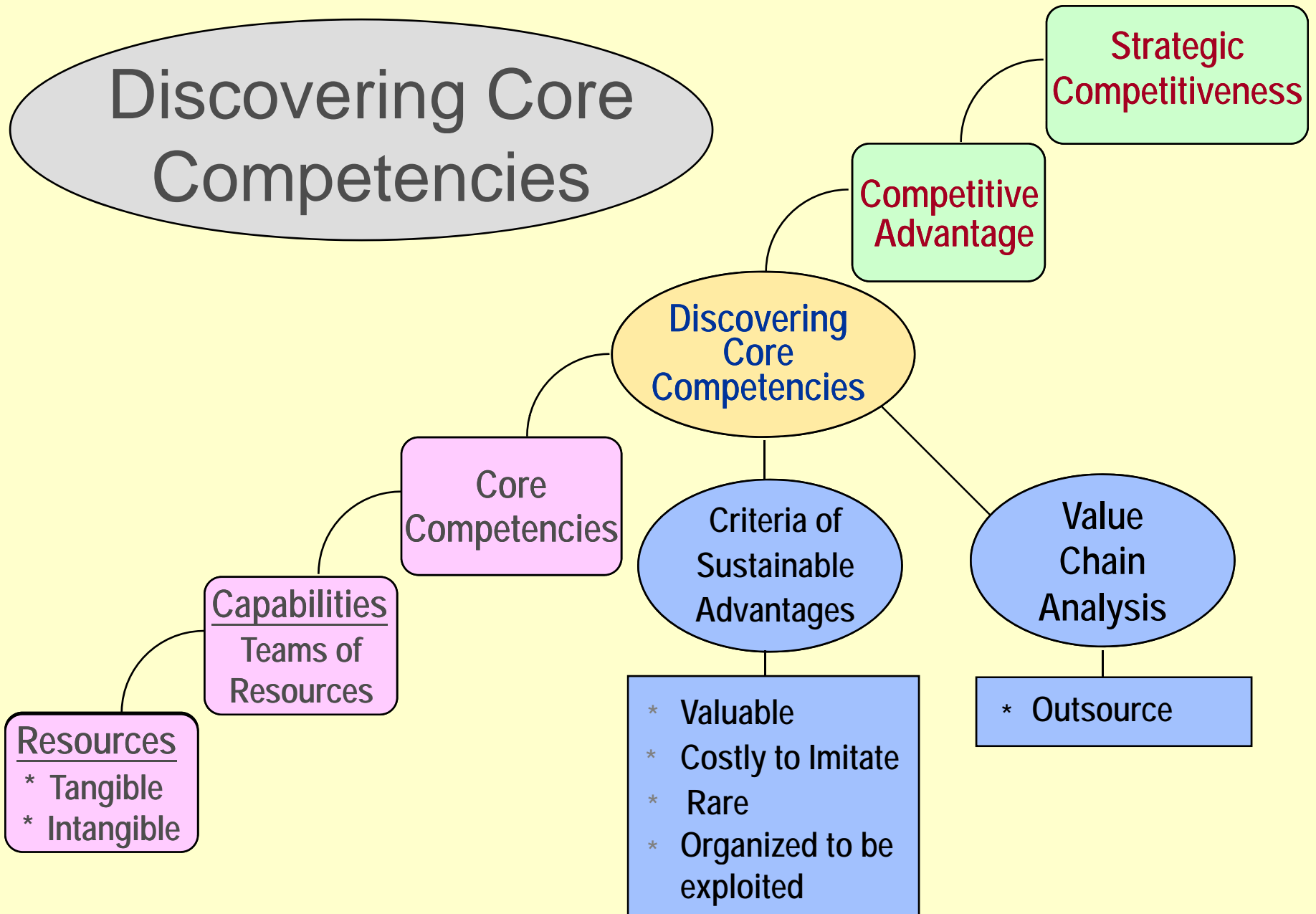
Select strategy that best exploits res.& capabilities relative to opportunities in environments.



The **Resource-Based** Model of Superior Returns

Action required:
Maintain selected strat.
in order to outperform
industry rivals.





Value

Value is measured by a product's performance characteristics and its attributes for which clients are willing to pay.

Core competencies in combination with product-market positions are the firm's most important sources of competitive advantage and should drive its selection of strategies.

Conditions Affecting Mgmt. Decisions About Resources, Capabilities & Core Competencies

- ▶ **Uncertainty** regarding characteristics of the general & the industry environments, competitor's actions, and customer's preferences
- ▶ **Complexity** regarding the interrelated causes shaping a firm's environments *and* perceptions of the environments
- ▶ **Intraorganizational Conflicts** among people making managerial decisions & those affected by them

Resources, Capabilities & Core Competencies

Tangible Resources

Financial Resources

- The firm's borrowing capacity
- The firm's ability to generate internal funds

Organizational Resources

- A firm's formal reporting structure & formal planning, controlling & coordinating systems

Physical Resources

- Sophistication & location of a firm's plant & equipment
- Access to raw materials

Resources

- * Tangible
- * Intangible

Technological Resources

- Stock of technology, such as patents, trademarks, copyrights, & trade secrets

Resources, Capabilities & Core Competencies

Intangible Resources

Human Resources

- Knowledge
- Trust
- Managerial capabilities
- Organizational routines

Innovation Resources

- Ideas
- Scientific capabilities
- Capacity to Innovate

Reputational Resources

- Brand name
- Reputation with Customer and Suppliers
- Perceptions of product quality, durability and reliability

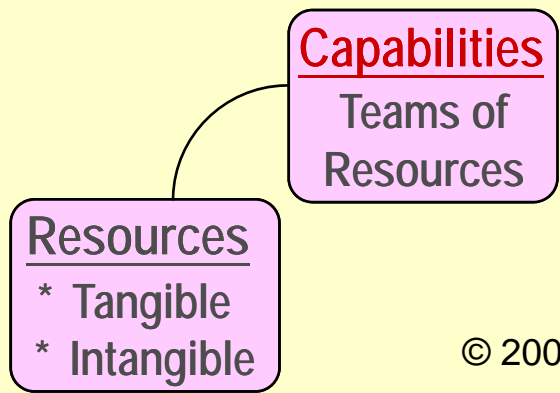
Resources

* Tangible

* Intangible

Resources, Capabilities & Core Competencies

<u>Functional Areas</u>	<u>Capabilities</u>	<u>Examples</u>
• Supply Chain Dist.	• Effective procurement techniques • Effective logistics mgmt. techniques	Starbucks Wal-Mart
• Human Res. Mgmt.	• Motivate, empower, retain employees	Royal Bank
• Info. Systems	• Effective / efficient inventory control via point-of-purchase data collection	Wal-Mart
• Marketing	• Effective promo of brand-name product • Effective Customer Service	Gillette McKinsey
• Management	• Ability to envision the future of clothing • Effective organizational structure • Effective culture	Nordstrom Gap, Inc. WestJet



Resources, Capabilities & Core Competencies

Functional Areas

Capabilities

Examples

• Manufacturing

- Design & production skills yielding reliable products
- Product & design quality
- Production of technologically sophisticated automobile engines
- Product & component miniaturization

Komatsu

Gap, Inc.
Mazda

Sony

• Research and Development

- Exceptional technological capability
- Development of sophisticated elevator control solutions
- Rapid transformation of technology into new products and processes
- Knowledge of silver-halide materials

Corning
Motion Control

Nucor Steel

Kodak

Capabilities

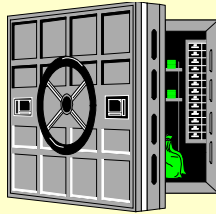
Teams of Resources

Resources

- * Tangible
- * Intangible

A core competency is a capability that is:

Valuable



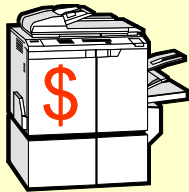
Allows a firm to neutralize threats or exploit opportunities in its external environment.

Rare



Possessed by few, if any, current and potential competitors.

Costly to
Imitate



When other firms either cannot obtain them or must obtain them at a much higher cost.

Organized
to be
Exploited



The firm must be organized appropriately to obtain full benefits of the resources in order to realize a competitive advantage.

Core
Competencies

Capabilities
Teams of
Resources

What Makes Core Competencies Costly to Imitate?

Unique Historical Conditions

An unusual evolutionary pattern of growth may contribute to the development of competencies in a manner that is unique to those particular circumstances

Causal Ambiguity

When competitors are unable to detect how a firm uses its competencies as a foundation for competitive advantage

Social complexity

When a firm's capabilities are a result of complex social phenomena, like interpersonal relationships, trust & friendships among managers or a firm's reputation with suppliers & customers

For Example:
Bombardier
created the
Skidoo when
Snowmobiles
were new

What Makes Core Competencies Organized to be exploited

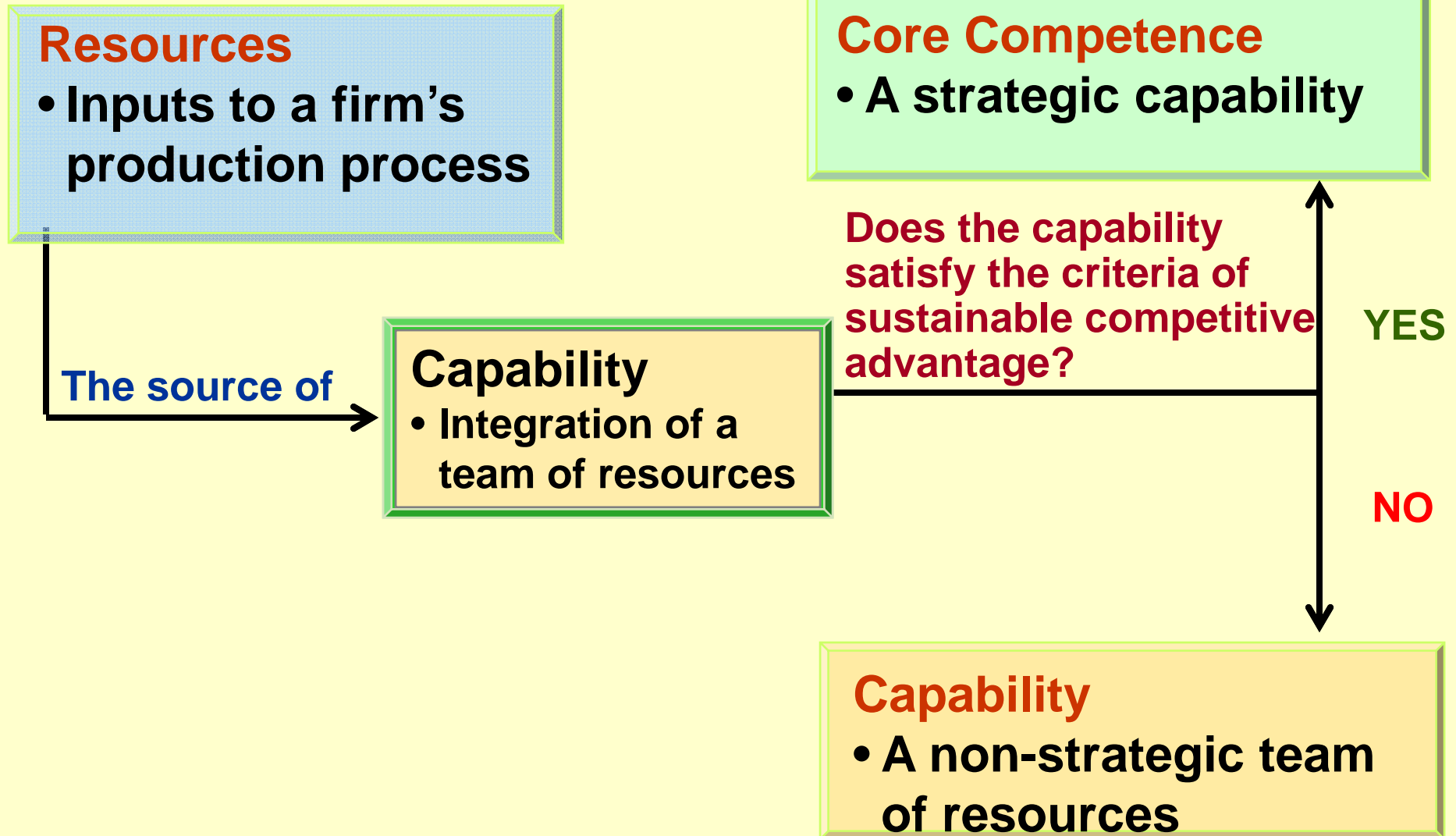
Organized to be exploited means that:

Organizational structures and control systems that allow a firm to take advantage of its resources

- * Appropriate structure to support capability
- * Appropriate control systems to support capability
- * Appropriate reward systems to support capability



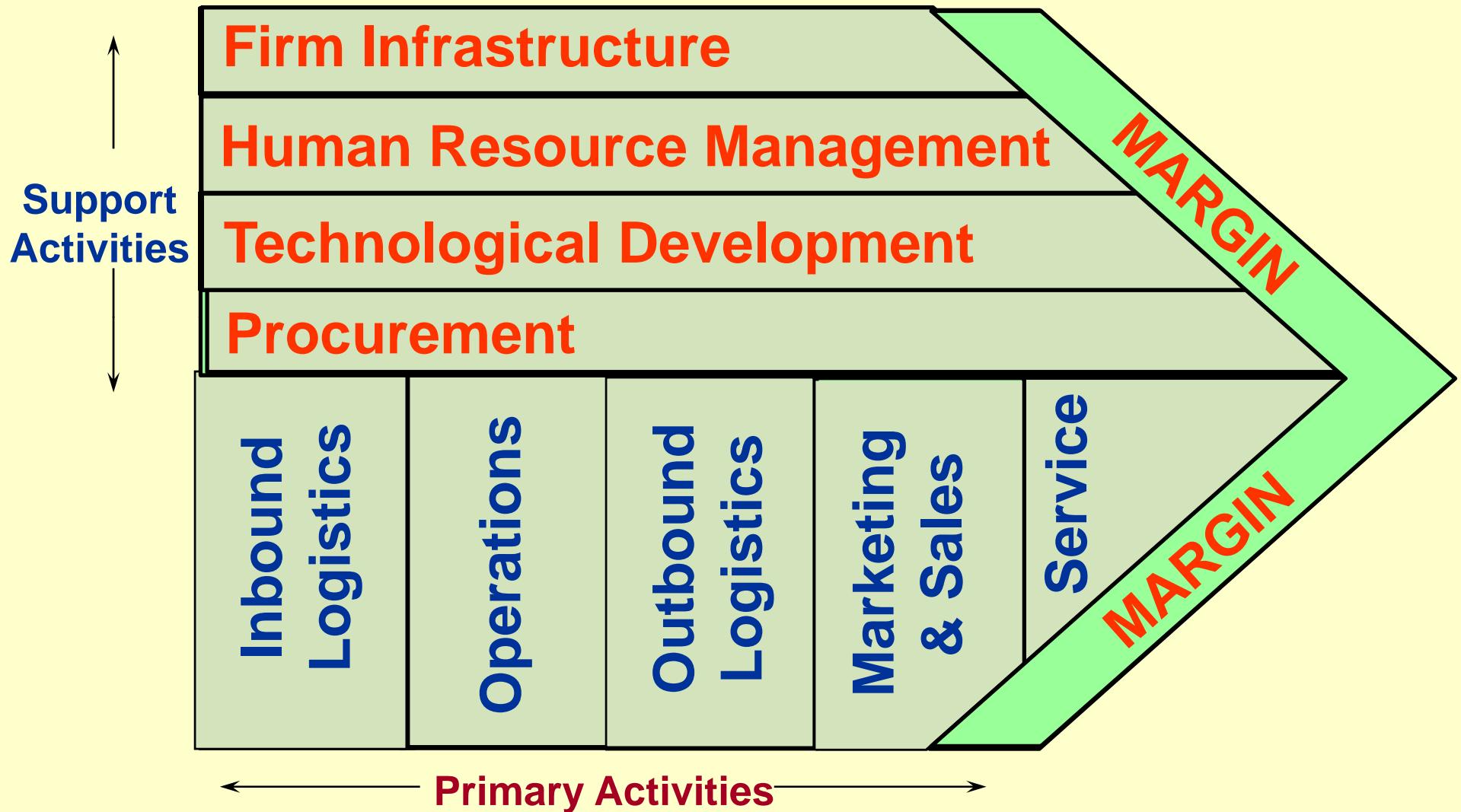
Core Competencies



The VRIO Framework

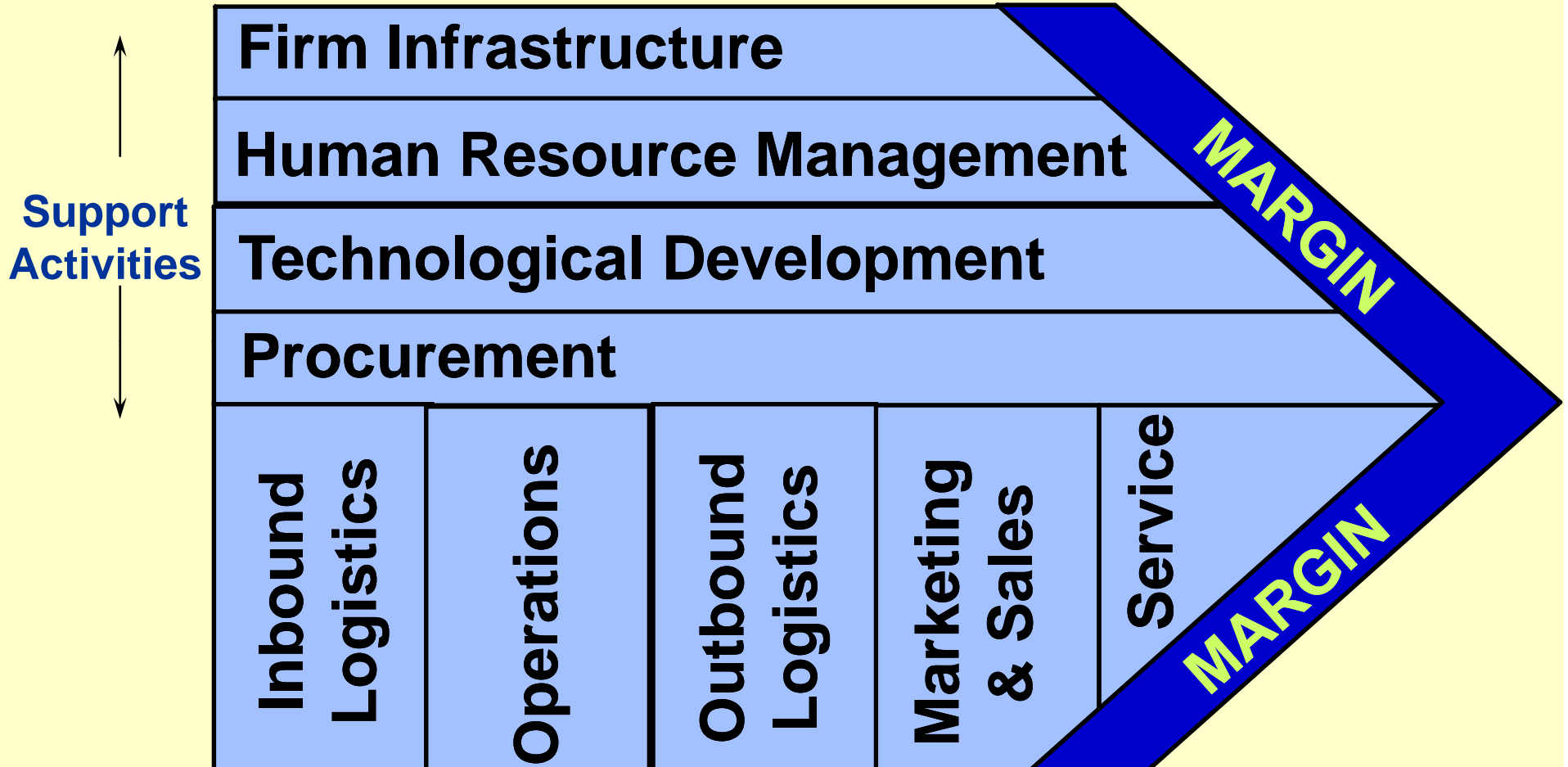
Valuable	Rare	Costly to Imitate	Org. to be Exploited	Competitive Consequences	Performance Implications
NO	NO	NO	NO	Competitive Disadvantage	Below Average Returns
YES	NO	NO	YES	Competitive Parity	Average Returns
YES	YES	NO	YES	Temporary Competitive Advantage	Avg./Above Average Returns
YES	YES	YES	YES	Sustainable Competitive Advantage	Above Average Returns

Value Chain Analysis



Outsourcing

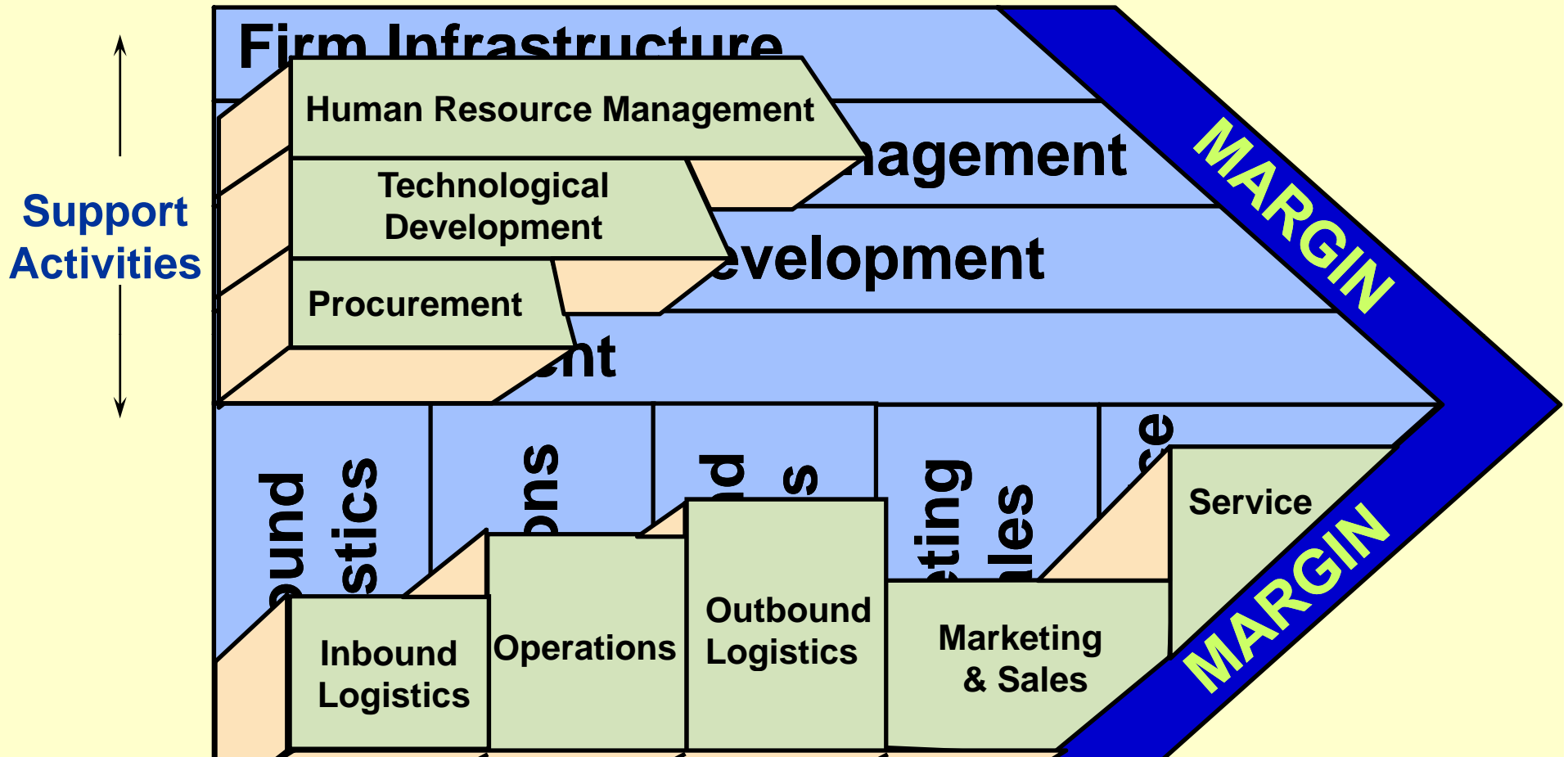
Strategic choice to purchase some activities from outside suppliers



Firms often buy a **portion** of their value-creating activities from specialty external suppliers who can perform these functions **more efficiently**.

Outsourcing

Strategic choice to purchase some activities from outside suppliers



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Strategic Rationales for Outsourcing

- **Improves Business Focus**

Lets company focus on broader business issues by having outside experts handle various operational details

- **Provides Access to World-Class Capabilities**

Outsourcing providers specialized resources make world-class capabilities available to firms in a wide range of applications

- **Accelerates Business Re-Engineering Benefits**

Outsiders (who already have world-class standards) take over the process and gain re-engineering benefits more quickly

Strategic Rationales for Outsourcing

- **Shares Risks**

Reduces investment requirements & makes firm more flexible, dynamic and better able to adapt to changing opportunities

- **Frees Resources for Other Purposes**

Permits firm to redirect efforts from non-core activities toward those that serve customers more effectively



Core Competencies--Cautions and Reminders

- Never take for granted that core competencies will continue to provide a source of competitive advantage.
- All core competencies have the potential to become *Core Rigidities*.
- **Core Rigidities**
 - They are former core competencies that sow the seeds of organizational inertia.
 - Prevent the firm from responding appropriately to changes in the external environment.