INTERNAL ENVIRONMENT: RESOURCES, CAPABILITIES AND CORE COMPETENCIES

There is only one underlying principle of war -- concentration of strengths against weaknesses.

Liddell Hart

Business Policy
Fall 2005

FORMULATING STRATEGY

UNDERSTANDING THE GAME

Industry Structure
Players, position, and intentions
Rules of the game, terms of competition

CHOOSING THE WEAPONS

Value Chain and CSFs
Organizational Resources
Core Competencies and Capabilities

Environment-Strategy Interface

Strategy Interface
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Notes

RESOURCE BASED APPROACH

Select strategy which:
- Exploits firm’s principal resources and competencies
- Ensures resources are fully and profitably employed
- Builds firm’s resource base

RESOURCES

TANGIBLE INTANGIBLE

Physical, Financial, Organizational

Innovation, Reputation, Culture

HUMAN SKILLS, KNOWLEDGE, COLLABORATION

CAPABILITIES/ CORE COMPETENCIES

COMPETITIVE ADVANTAGE

TANGIBLE RESOURCES

- Financial
  - Firm’s borrowing capacity
  - Ability to generate internal funds
- Physical
  - Sophistication of firm’s plant and equipment
  - Access to raw materials
- Organizational
  - Formal planning, controlling and coordinating systems
- Technological
  - Stock of technology – patents, trademarks, copyrights

INTANGIBLE RESOURCES

- Innovation/ Creativity
  - Stock of technology – patents, trademarks, copyrights
  - Knowledge required
- Reputation
  - Reputation with customers
    - Brand name
    - Perceptions of product quality, durability and reliability
  - Reputation with suppliers
    - Effective, efficient and supportive relationships
- Culture
  - Relationships with CSFs
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**HUMAN RESOURCES**
- Skills/know-how ➤ Competency modeling
- Capacity for communication and collaboration ➤ Ability to harmonize efforts ➤ Integrate separate skills
- Motivation ➤ Productivity

KEY QUESTIONS FOR MANAGERS INCLUDE...
How do we assemble bundles of Resources, Capabilities and Core Competencies to...

And...
- Will environmental changes make our core competencies obsolete?
- Are substitutes available for our core competencies?
- Are our core competencies easily imitated?

Create VALUE for Customers

**RESOURCE ANALYSIS**
1. Identify firm's resources
2. Identify firm's capabilities: What can it do?
3. Identify potential of capabilities for creating, sustaining and exploiting competitive advantage
4. Select strategy that best exploits firm's capabilities relative to opportunities
5. Identify resource gaps which need to be filled: Replenish and augment resource base.
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Notes

RESOURCE BASED STRATEGY: HONDA


- 4-cycle engines
- 405cc motorcycle
- Related Products: ground tillers, marine engines, generators, pumps
- Clip on engines for bicycles
- 50 cc super cub
- N360 Mini Car
- 1000cc Goldwing touring motorcycle
- Acura Car Division

CORE COMPETENCE

Resources
Inputs to a firm’s production process

Capability
Integration of a team of resources

Core Competence
A strategic capability

If it results in sustainable competitive advantage

LEVERAGING RESOURCES INTO CAPABILITIES

- Concentrating resources
  - Converging resources on a few clearly defined and consistent goals
  - Targeting those activities that have the biggest impact on customers' perceived value
- Accumulating resources through mining experience
  - Including borrowing/learning from other firms
- Complementing resources
  - Increasing effectiveness through linking them with complementary resources and capabilities
- Conserving resources
  - Utilizing resources to the fullest by recycling them through different products, markets

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CANON: PRODUCTS AND CAPABILITIES

- Precision Mechanics
- Fine Optics
- 35 mm SLR Cameras
- EOS Autofocus cameras
- Digit cameras
- Camcorders
- Inkjet printer
- Laser printer
- Fax machines
- Calculators
- Notebook computer
- Micro-Electronics
- Plain-paper copier
- Color copiers
- Inkjet printer
- Laser printer
- Plain-paper copier
- Color copier

ASSESSING CAPABILITIES

<table>
<thead>
<tr>
<th>VALUE</th>
<th>Do firm’s capabilities enable it to respond to environmental threats and opportunities?</th>
</tr>
</thead>
<tbody>
<tr>
<td>RARENESS</td>
<td>How many competing firms already possess particular valuable resources/capabilities?</td>
</tr>
<tr>
<td>IMITABILITY</td>
<td>Do firms face a cost disadvantage in developing a capability compared to those that possess it?</td>
</tr>
<tr>
<td>SUBSTITUTABILITY</td>
<td>Are substitutes readily available for a firm’s capabilities?</td>
</tr>
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PROFIT GENERATING CAPACITY OF RESOURCES AND CAPABILITIES

| APPROPRIABILITY | Divisions of rents between the firm and the owners of the resources |
| DURABILITY | Life-span and rate of depreciation of resources and capabilities |
| TRANSFERABILITY | Ease with which resources can be transferred to rivals |
| REPLICABILITY | Difficulty and time required for rivals to replicate the firm’s resources and capabilities |
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**SOURCES OF CAUSAL AMBIGUITY**

- Complexity of capability-based advantage
- Tacit nature of capability-based advantage

From: Saloner, Shepard & Podolny (2001)

**TOYOTA'S “LEAN PRODUCTION” CAPABILITY**

- Continuous improvement
- Component manufacture
- Inventory control
- Supply Chain management
- Quality control
- Assembly processes
- Production scheduling

**COMPETITIVE IMPLICATIONS**

<table>
<thead>
<tr>
<th>VALUABLE?</th>
<th>RARE?</th>
<th>DIFFICULT NON TO IMITATE?</th>
<th>SUBSTITUTE</th>
<th>IMPLICATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>Competitive Disadvantage</td>
</tr>
<tr>
<td>YES</td>
<td>NO</td>
<td>YES/NO</td>
<td>NO</td>
<td>Competitive Parity</td>
</tr>
<tr>
<td>YES</td>
<td>YES</td>
<td>NO</td>
<td>YES/NO</td>
<td>Temporary Comp. Advantage</td>
</tr>
<tr>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>Sustainable Comp. Advantage</td>
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CAPABILITY DEVELOPMENT

- Developing individual competencies
- Develop human resources required for a particular capability
- Corporate acquisitions
  - Short-circuiting the process by acquiring a firm with the capability
- Acquiring capabilities through strategic alliances
  - Observing, evaluating and absorbing the capabilities of alliance partner
- Incubating capabilities
  - Developing new capabilities in organizationally separate units

VALUE CHAIN

CAPABILITIES

- Innovation
  - Lower Unit Costs
  - Higher Unit Prices
  - Customer Responsiveness
  - Efficiency
  - Quality
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Notes

CORE COMPETENCIES—CAUTIONS
It should never be taken for granted that core competencies will continue to provide a source of competitive advantage.
All core competencies have the potential to become rigidities—core rigidities—that prevent the firm from responding appropriately to changes in the external environment.

Strategic myopia and inflexibility can strangle the firm’s ability to grow and adapt to environmental change or competitive threats.

McKINSEY BUSINESS SYSTEM

TECHNOLOGY
- Source
- Patents
- Product
- Process

PROD. DESIGN
- Function
- Physical appearance
- Aesthetics
- Process

MANUFACTURING
- Integration
- Raw materials
- Location
- Automation
- Capacity
- Quality
- Assembly

MARKETING
- Prices
- Advertising
- Sales force
- Package
- Brand
- Channels
- Inventory
- Transport
- Warranty
- Speed
- Price
- Quality

DISTRIBUTION

SERVICE
- Warranty
- Speed
- Price
- Quality

CREATING VALUE IN A KNOWLEDGE-INTENSIVE ECONOMY

- Leveraging Human Capital
  - Attracting/recruiting “top-notch” human capital
  - Developing human capital
  - Retaining human capital
- Leveraging Social Capital
  - Creating effective teams
- Knowledge creation and mobilization
  - Transferring best practices
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**BENEFITS AND COSTS OF USING MARKET**

<table>
<thead>
<tr>
<th>BENEFITS</th>
<th>COSTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Market firms can achieve economies of scale that in-house departments cannot</td>
<td>• Coordination of production flows may be compromised</td>
</tr>
<tr>
<td>• Market firms are subject to discipline of the market and must be innovative and efficient to survive</td>
<td>• Private information may be leaked when activity is performed by market firm</td>
</tr>
<tr>
<td></td>
<td>• Costs of transacting with independent firm</td>
</tr>
</tbody>
</table>

**KNOWLEDGE ACCUMULATION AND MOBILIZATION**

- Creation
- Acquisition
- Retention
- Identification
- Willingness to share and receive knowledge
- Transmission

**CHALLENGES IN KNOWLEDGE ACCUMULATION**

**CREATION**
- Complacence
- Low-decision making discretion
- Absence of an internal market for ideas

**ACQUISITION**
- Failure to be an early mover in knowledge acquisition
- Inability to integrate and apply external knowledge

**RETENTION**
- Employee turnover
- Bleed-through proprietary knowledge to competitors
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CHALLENGES IN KNOWLEDGE MOBILIZATION

IDENTIFICATION
- “Halo” effect

OUTFLOW
- “How does it help me?” syndrome
- “Knowledge is power” syndrome
- Incentives tied to internal performance

INFLOW
- “NIH” (not invented here) syndrome
- Reluctance to acknowledge the superiority of peers

COMPETITOR ANALYSIS

GOALS AND OBJECTIVES

STRATEGY

COMPETITOR’S RESPONSE PROFILE

ASSUMPTIONS

CAPABILITIES

WHAT DRIVES THE COMPETITOR

GOALS/OBJECTIVES
- What are the current goals? How do they compare with ours?
- Does current performance meet current goals?
- How will goals change in the future?
- What is their attitude towards risk?

ASSUMPTIONS
- What assumptions does it have about itself?
- What assumptions does it have about the industry and other competitors

Notes
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COMPETITOR ANALYSIS
WHAT THE COMPETITOR IS DOING OR CAN DO

- STRATEGY
  - How is the firm competing?
  - Do their strategy support changes in the competitive structure?

- CAPABILITIES
  - What are its principal strengths and weaknesses?
  - What are its quick response ability and staying power?

ASSESSING STRENGTHS AND WEAKNESSES

- Measures
  - Financial (Ratio analysis; Economic Value-added/EVA analysis)
  - Non-financial quantitative (No. of patents, market share, employee turnover etc.)
  - Qualitative measures

- Comparison standards
  - Industry norms
  - Key competitors (members of strategic group)
  - Benchmarks
  - Historical standards

BENCHMARKING

Identifying activities or functions that need improving

Identifying companies that are world leaders and analyzing how they do such activities well

Using the learning to redesign processes and change expectations regarding own functions and activities
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COMPETITOR ANALYSIS: APPLICATIONS

- PREDICTING BEHAVIOR
  - Response to proposed strategic moves
  - Reaction to environmental shifts

- PICKING THE BATTLEGROUND

- INFLUENCING COMPETITORS' BEHAVIOR
  - Signalling and deterrence strategies