Lecture 2

Strategic analysis

The internal environment

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2. The internal environment

Learning objectives

- Explain why firms need to ***understand*** their internal organization.
- Define ***value***.
- Differentiate tangible and intangible ***resources***.
- Define criteria that make resources and capabilities a ***core*** competency.
- Use ***value chain*** analysis.
- Define the importance of identifying internal ***strengths and weaknesses.***

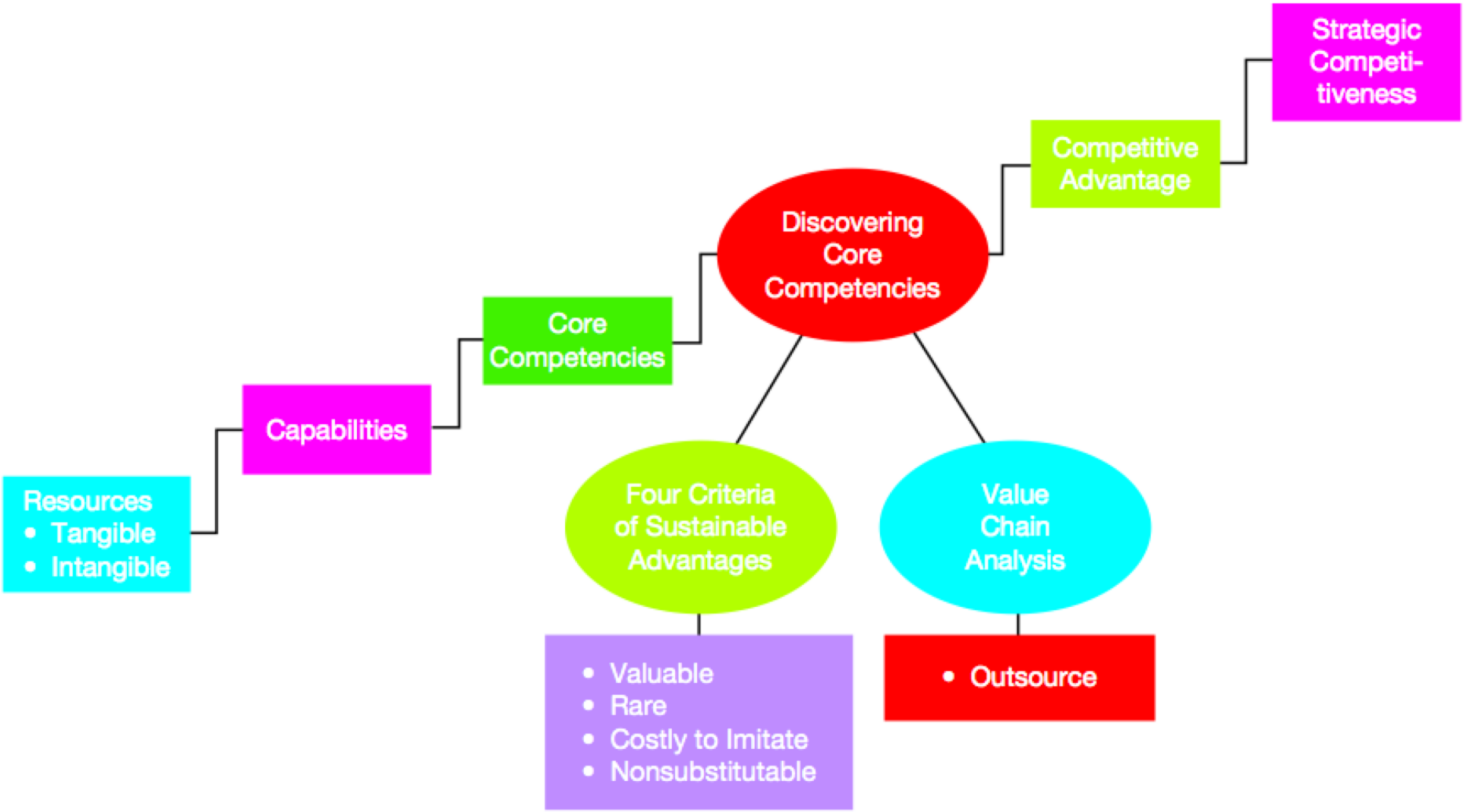
Opening case

- Gazprom

Analysing the internal organization 1/4

- A global mindset is the ability to analyze, understand and manage an internal organization in ways that are ***not dependent*** on the assumptions of a single country, culture or context.
- Analysis requires that evaluators examine the ***portfolio*** of resources and the ***bundles*** of resources that managers have created.

FIGURE 3.1 Components of internal analysis leading to competitive advantage and strategic competitiveness



Analysing the internal organization 3/4

- Firms create value by ***exploiting*** resources.
- Value is measured by a product performance characteristics and by its ***attributes*** for which the customers are ***willing to pay***.

Resources 1/3

- Cover a broad scope of phenomena.
- Alone do not yield a competitive advantage, but in ***bundles***.
- ***Tangible*** assets are resources that can be observed and quantified.
- ***Intangible*** assets include resources deeply rooted in the firm's history, accumulated over time, and relatively difficult for competitors to understand and duplicate.

Table 3.1 Tangible resources

Financial Resources	• The firm's borrowing capacity • The firm's ability to generate internal funds
Organizational Resources	• The firm's formal reporting structure and its formal planning, controlling, and coordinating systems
Physical Resources	• Sophistication and location of a firm's plant and equipment • Access to raw materials
Technological Resources	• Stock of technology, such as patents, trademarks, copyrights, and trade secrets

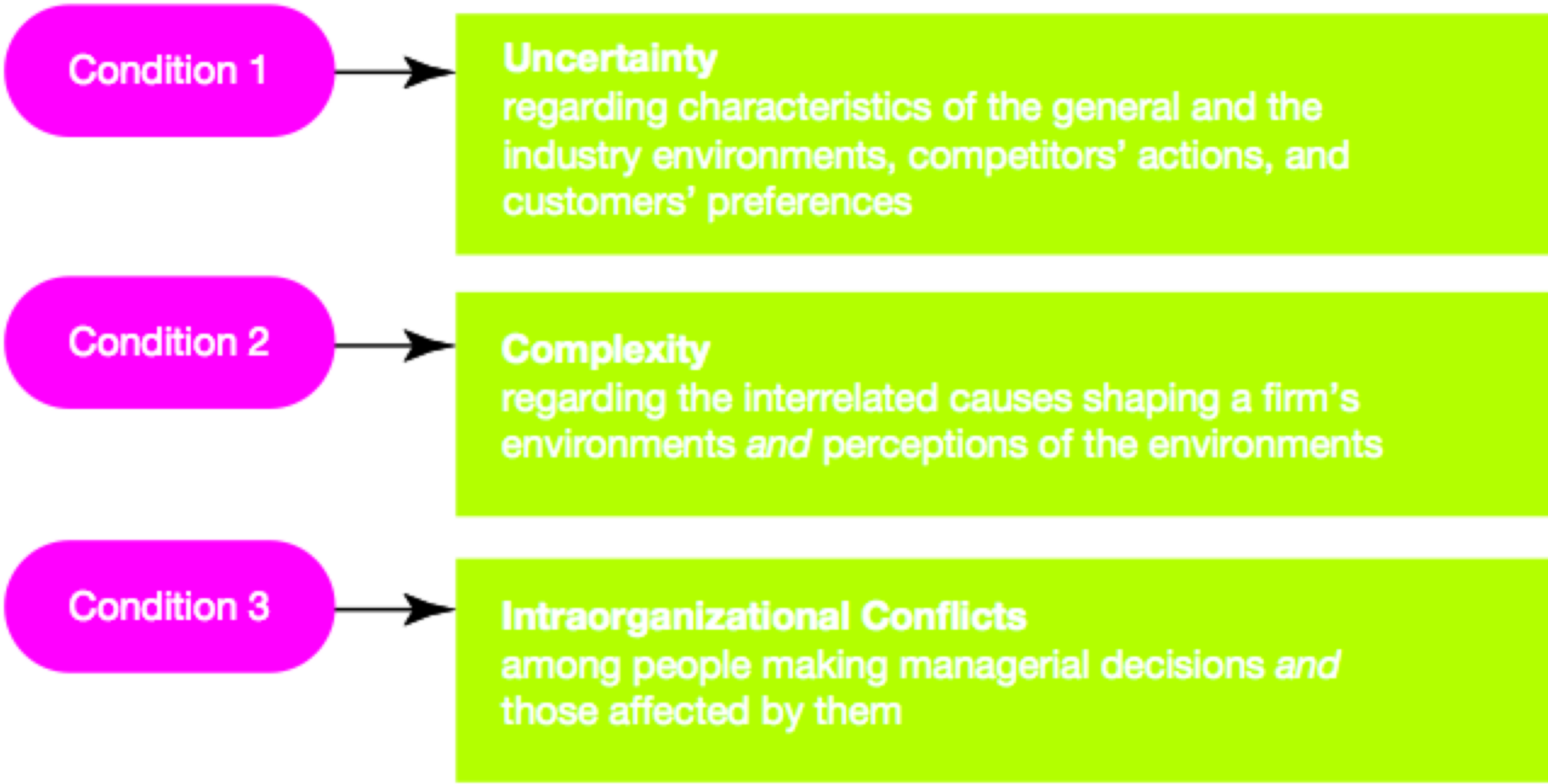
Sources: Adapted from J. B. Barney, 1991, "Firm resources and sustained competitive advantage", *Journal of Management*, 17: 101; R. M. Grant, 1991, *Contemporary Strategy Analysis*, Cambridge, UK: Blackwell Business, 100–102.

Table 3.2 Intangible resources

Human Resources	• Knowledge • Trust • Managerial capabilities • Organizational routines
Innovation Resources	• Ideas • Scientific capabilities • Capacity to innovate
Reputational Resources	• Reputation with customers • Brand name • Perceptions of product quality, durability and reliability • Reputation with suppliers • For efficient, effective, supportive, and mutually beneficial interactions and relationships

Sources: Adapted from R. Hall, 1992, "The strategic analysis of intangible resources", *Strategic Management Journal*, 13: 136–139; R. M. Grant, 1991, *Contemporary Strategy Analysis*, Cambridge, UK: Blackwell Business, 101–104.

FIGURE 3.2 Conditions affecting managerial decisions about resources, capabilities and core competencies



Source: Adapted from R. Amit and P. J. H. Schoemaker, 1993, "Strategic assets and organizational rent", *Strategic Management Journal*, 14: 33.

:cessful decisions when no obviously correct model or rule is available or when rele

Capabilities and Core Competencies

- Capabilities exist when resources have been purposefully integrated in order to achieve a specific tsk or set of tasks.
- Capabilities are often based on developing, carrying and exchanging information through firm's human capital.
- Core competencies are capabilities that serve as sources of competitive advantage for a firm over its rivals.

Building core competencies

- Firms determine those capabilities that are core competence using ***four specific criteria***.
- Firms select the value-creating competencies that should be maintained, upgraded or developed and those that should be outsourced by using the ***value chain analysis***.

Table 3.4 The four criteria of sustainable competitive advantage

Valuable Capabilities	• Help a firm neutralize threats or exploit opportunities
Rare Capabilities	• Are not possessed by many others
Costly-to-Imitate Capabilities	• Historical: A unique and a valuable organizational culture or brand name • Ambiguous cause: The causes and uses of a competence are unclear • Social complexity: Interpersonal relationships, trust, and friendship among managers, suppliers, and customers
Nonsubstitutable Capabilities	• No strategic equivalent

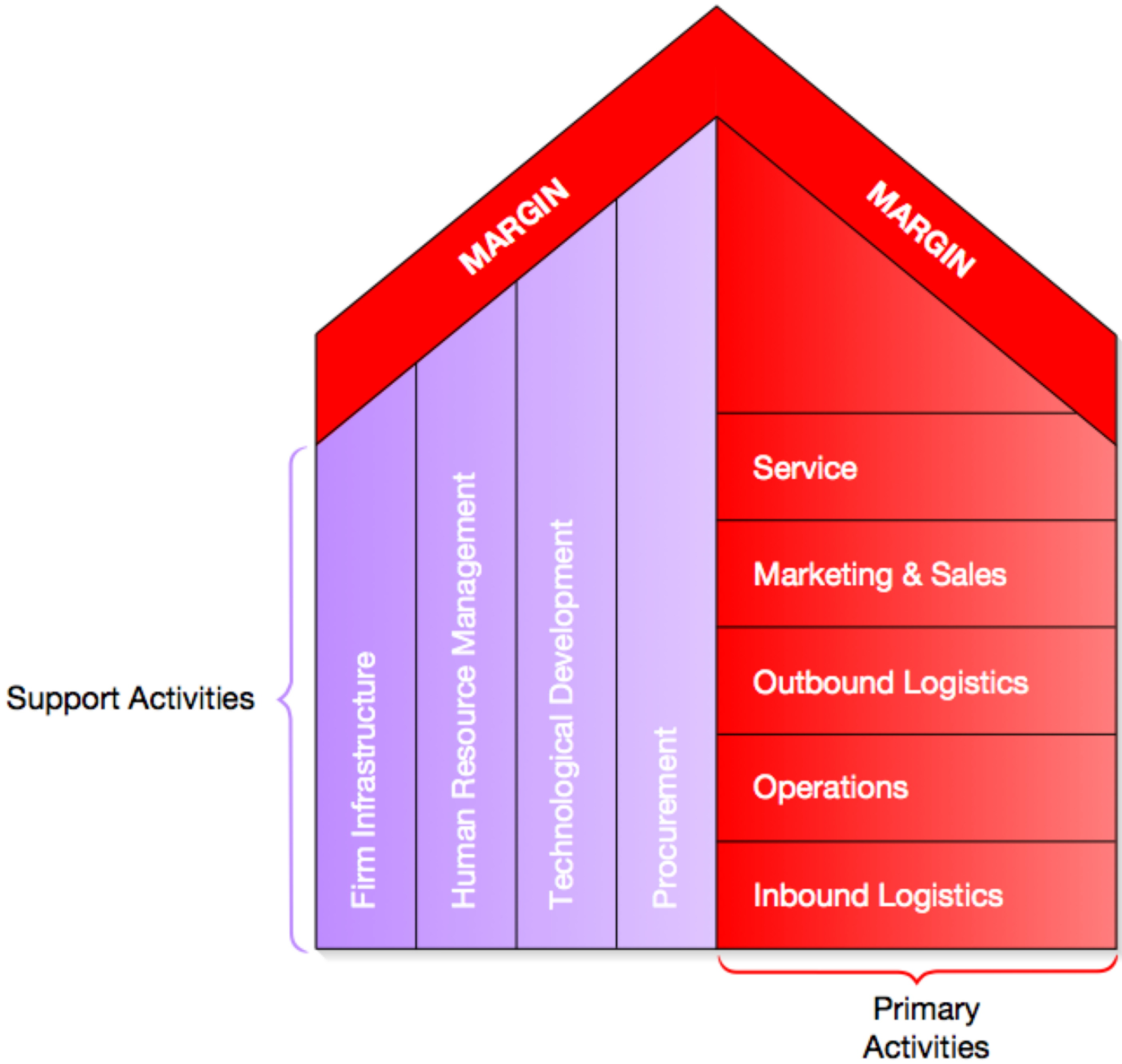
VRIN criteria 2/2

- Ryanair case

Value chain analysis 1/5

- Value chain allows the firm to understand the ***parts*** of its operations that create value and those that do not.
- The value chain is a ***template*** that firms use to determine their ***cost position*** and to identify multiple ***means*** that can be used to implement a chosen business strategy.

FIGURE 3.3 The basic value chain



Value chain analysis 3/5

- Primary activities are involved with a product's physical creation, its sale and distribution to customers, and the service after sale.
- Support activities provide the necessary assistance for the primary activities to take place.

Value chain analysis 4/5

Table 3.6 Examining the value-creating potential of primary activities

Inbound Logistics Activities, such as materials handling, warehousing, and inventory control, used to receive, store, and disseminate inputs to a product.
Operations Activities necessary to convert the inputs provided by inbound logistics into final product form. Machining, packaging, assembly, and equipment maintenance are examples of operations activities.
Outbound Logistics Activities involved with collecting, storing, and physically distributing the final product to customers. Examples of these activities include finished-goods warehousing, materials handling, and order processing.
Marketing and Sales Activities completed to provide means through which customers can purchase products and to induce them to do so. To effectively market and sell products, firms develop advertising and promotional campaigns, select appropriate distribution channels, and select, develop, and support their sales force.
Service Activities designed to enhance or maintain a product's value. Firms engage in a range of service-related activities, including installation, repair, training, and adjustment.
Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as *superior, equivalent,* or *inferior.*

Source: Adapted with the permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group, from *Competitive Advantage: Creating and Sustaining Superior Performance,* by Michael E. Porter, 39–40, Copyright © 1985, 1998 by Michael E. Porter.

Value chain analysis 5/5

Table 3.7 Examining the value-creating potential of support activities

Procurement Activities completed to purchase the inputs needed to produce a firm's products. Purchased inputs include items fully consumed during the manufacture of products (e.g., raw materials and supplies, as well as fixed assets – machinery, laboratory equipment, office equipment, and buildings).
Technological Development Activities completed to improve a firm's product and the processes used to manufacture it. Technological development takes many forms, such as process equipment, basic research and product design, and servicing procedures.
Human Resource Management Activities involved with recruiting, hiring, training, developing, and compensating all personnel.
Firm Infrastructure Firm infrastructure includes activities such as general management, planning, finance, accounting, legal support, and governmental relations that are required to support the work of the entire value chain. Through its infrastructure, the firm strives to effectively and consistently identify external opportunities and threats, identify resources and capabilities, and support core competencies. Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as *superior, equivalent,* or *inferior.*

Source: Adapted with the permission of The Free Press, an imprint of Simon & Schuster Adult Publishing Group, from *Competitive Advantage: Creating and Sustaining Superior Performance*, by Michael E. Porter, 40–43, Copyright © 1985, 1998 by Michael E. Porter.

Outsourcing 1/2

- Outsourcing is the ***purchase*** of a value-creating activity from an external supplier.
- Firms engaged in effective outsourcing increase their ***flexibility***, mitigate ***risks*** and reduce their ***capital*** investments.
- Firms ***must*** outsource activities where they cannot create value or where they are at substantial disadvantage compared to competitors.

Outsourcing 2/2

- Outsourcing causes additional concerns:
  - loss in firm’s innovative capability,
  - loss of jobs,
- Still outsourcing is a big business, and fast growing globally.

Strengths and Weaknesses 1/2

- At the conclusion of internal analysis firms must identify their strengths and weaknesses in resources, capabilities and core competencies.
- Having a significant amount of resources does not mean these are the right resources.
- If emphasized longer than necessary a core competence may become source of inertia.

Strenghts and Weaknesses 2/2

- RIM (Blackberry) case:
  - secure mobile phones,
  - primary customers are big firms and government,
  - peer-to-peer encryption,
  - governments pressure to get access to encrypted data.

Summary 1/2

- The resources, capabilities and core competencies are likely to have a ***stronger*** influence on firm's success than the external environment.
- No competitive advantage ***lasts*** forever.
- Effectively managing core competencies requires careful ***analysis*** of resources and capabilities.
- Individual resources are ***rarely*** a source of competitive advantage.

Summary 2/2

- Only when ***VRIN*** a capability can be source of competitive advantage.
- Value chain analysis is used to identify and evaluate the competitive ***potential*** of resources and capabilities.
- When firms cannot create value internally ***outsourcing*** is considered.