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in Global Governance

Business Strategy

Topic 3
The Internal Organization:
Resources, Capabilities,
Core Competencies, and Competitive Advantages

H. Volberda, R. Morgan, P. Reinmoller, R. Ireland, R. Hoskisson,
Strategic Management. *Competitiveness and Globalization*. *Concepts and Cases*,
Cengage Learning, 2016.

KNOWLEDGE OBJECTIVES

- Explain the importance of understanding of **internal organization**
- Describe **tangible** and **intangible resources**
- Describe **Resources, Capabilities** and **Core Competences**
- Define **Outsourcing**
- Discuss the importance of identifying **internal strengths** and **weaknesses**.

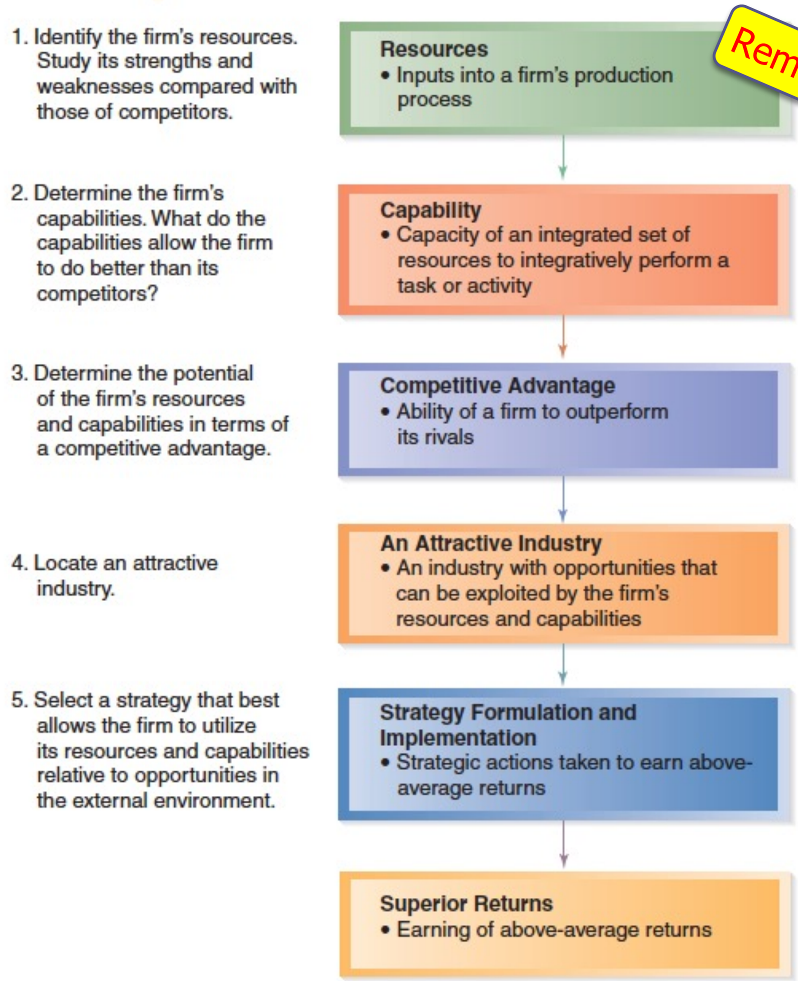
Reminder

The Resource-Based Model of Above-Average Returns

- Each organization is a collection of unique resources and capabilities. The uniqueness of its resources and capabilities is the basis for a firm's strategy.

- Resources are inputs into a firm's production process, such as capital equipment, the skills of individual employees, patents, finances, and talented managers.
- Capability is the capacity for a set of resources to perform a task or an activity in an integrative manner.
- Core competencies are capabilities that serve as a source of competitive advantage for a firm over its rivals.

The Resource-Based Model of Above-Average Returns



Reminder

Analyzing the Internal Organization

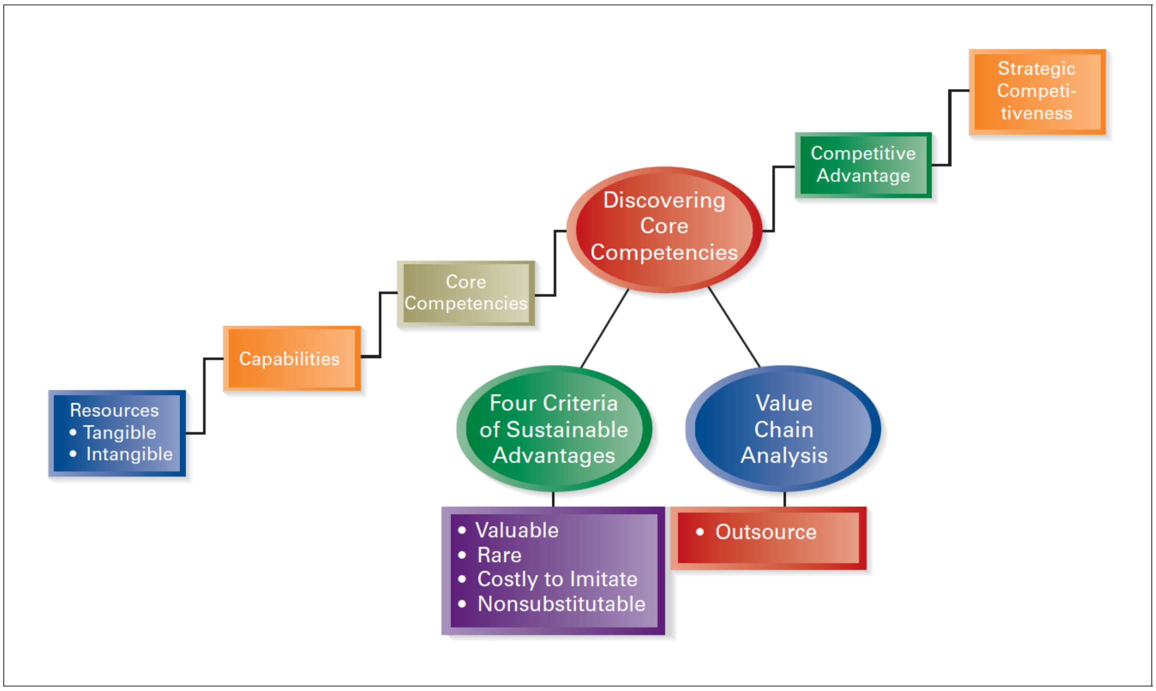


Figure 3.1 Components of Internal Analysis Leading to Competitive Advantage and Strategic Competitiveness

Resources - Tangible resources

- **Tangible resources** are assets that can be observed and quantified.

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

Resources - Intangible resources

- **Intangible resources** include assets that are rooted deeply in the firm's history, accumulate over time, and are relatively difficult for competitors to analyze and imitate.

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

Capabilities

- Capabilities exist when resources have been purposely integrated to achieve a specific task or set of tasks.
- Capabilities are often developed in specific functional areas:

• Distribution • Human resources • Management information systems • Marketing	• Management • Manufacturing • Research & Development

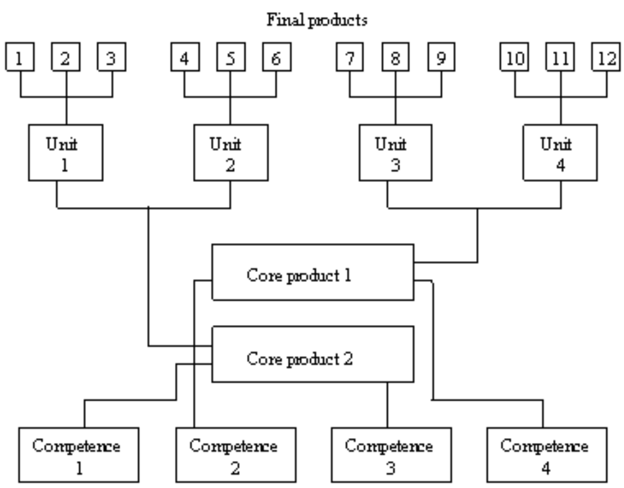
- There should be also "dynamic capabilities"

Resources/capabilities and value

- Value is measured by a product's performance characteristics and by its attributes for which customers are willing to pay.
- Companies are creating value by innovative bundling and leveraging their resources and capabilities; by exploiting their core competencies or competitive advantages, firms create value.

Core competencies

- Core competencies are capabilities that serve as a source of competitive advantage for a firm over its rivals
  - Provide access to a wide range of markets
  - Contributes heavily to customer perceived benefits
  - Cannot be easily copied by competitors



Strategies based on internal resources and competences

Beyond initial resources availability, it is key how the company is able to use these resources (by stretch and leverage)

1. Leverage on existing resources → Can allow companies with less resources to compete and overcome companies with larger investments and budgets
2. Create new competences → Referring not only to consolidated past experiences but also to radically innovating technology or marketing approach (often new comers are at an advantage)
3. Replicate competences → Can be very effective in order to extend the business. Codification is often key

Challenges in analyzing the Internal Organization

- The strategic decisions managers make in terms of the firm's resources, capabilities, and core competencies are nonroutine, have often ethical implications, and significantly influencethe firm's ability to earn above-average returns

Uncertainty
Complexity
Intraorganizational Conflicts

Building upon competencies

Two tools help firms identify and build their strategy upon key competencies:

- **Four Criteria of Sustainable Competitive Advantage**
to determine those capabilities that are key.

- **Value Chain Analysis**
to select the value-creating competencies that should be maintained, upgraded, or developed and those that should be outsourced.

Four Criteria of Sustainable Competitive Advantage

Capabilities are core competencies if they are:

- **Valuable** capabilities allow the fi rm to exploit opportunities or neutralize threats in its external environment.
- **Rare** capabilities are capabilities that few, if any, competitors possess.
- **Costly-to-imitate** capabilities are capabilities that other firms cannot easily develop.
- **Non substitutable** capabilities are capabilities that do not have strategic equivalents.

Four Criteria of Sustainable Competitive Advantage

Is the Resource or Capability Valuable?	Is the Resource or Capability Rare?	Is the Resource or Capability Costly to Imitate?	Is the Resource or Capability Nonsubstitutable?	Competitive Consequences	Performance Implications
No	No	No	No	Competitive disadvantage	Below-average returns
Yes	No	No	Yes/no	Competitive parity	Average returns
Yes	Yes	No	Yes/no	Temporary competitive advantage	Average returns to above-average returns
Yes	Yes	Yes	Yes/no	Sustainable competitive advantage	Above-average returns

Outcomes from Combinations of the Criteria for Sustainable Competitive Advantage

Value Chain Analysis

Value chain analysis allows the firm to understand the parts of its operations that create value and those that do not.

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

Value Chain Analysis

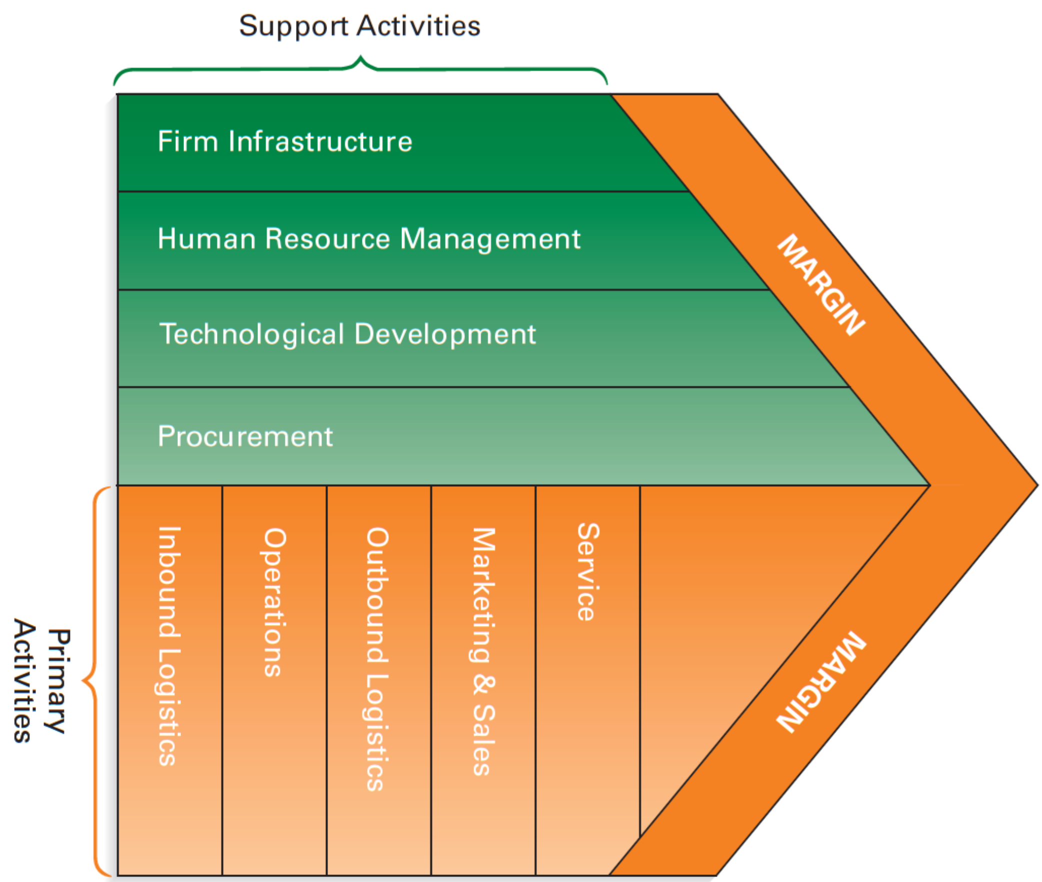


Figure 3.3 **The Basic Value Chain**

The Value-Creating Potential of **Primary Activities**

- Inbound Logistics: such as materials handling, warehousing, and inventory control, used to receive, store, and disseminate inputs to a product.
- Operations: such as machining, packaging, assembly, and equipment maintenance are examples of operations activities.
- Outbound Logistics: such as finished-goods warehousing, materials handling, and order processing.
- Marketing and Sales: such as advertising and promotional campaigns, select appropriate distribution channels, and select, develop, and support their sales force.
- Service: such as installation, repair, training, and adjustment

The Value-Creating Potential of **Support Activities**

- Procurement: Activities completed to purchase the inputs needed to produce a fi rm's products. Purchased inputs include items fully consumed during the manufacture of products (e.g., raw materials and supplies,machinery, laboratory equipment, office equipment, and buildings).
- Technological Development: Activities completed to improve a fi rm'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: Includes activities such as general management, planning, fi nance, accounting, legal support, and governmental relations that are required to support the work of the entire value chain.

Value Chain Analysis

To be a source of competitive advantage, a resource or capability must allow the firm

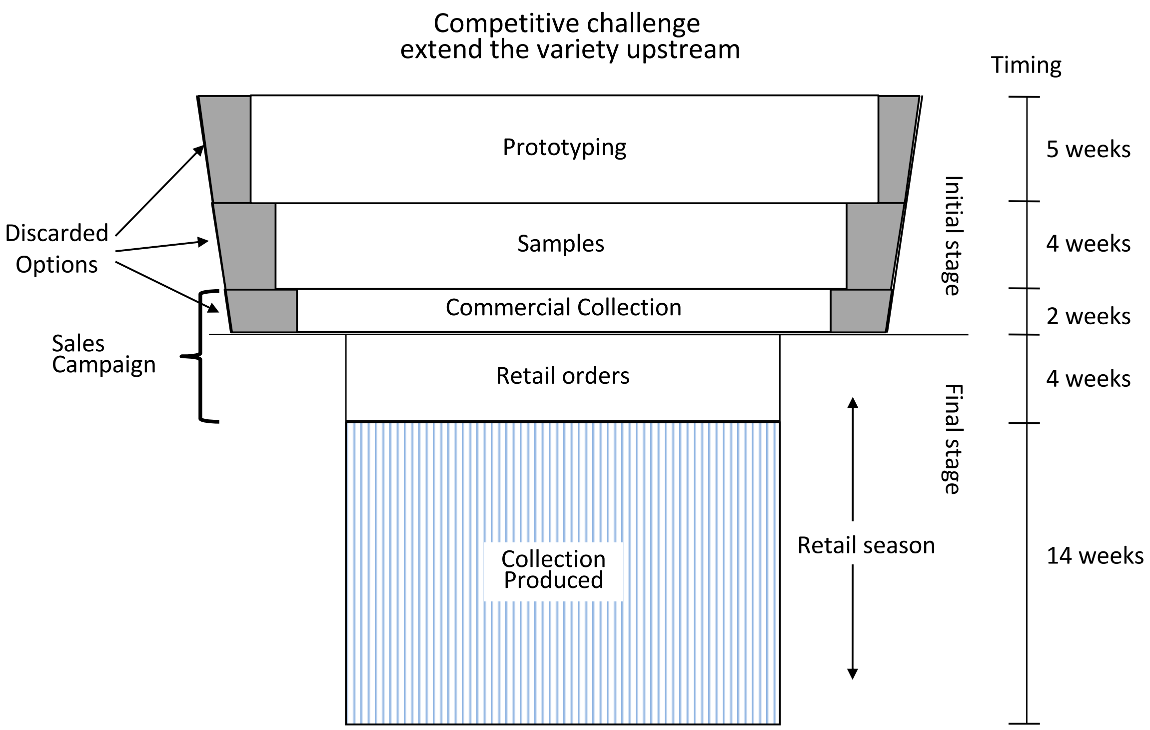
(1) to perform an activity in a manner that provides value superior to that provided by competitors,

or

(2) to perform a value-creating activity that competitors cannot perform.

Only under these conditions does a firm create value for customers and have opportunities to capture that value.

Collection development & launch



Source: Cerruti and Harrison, Gucci case, 2005

Gucci brief profile (as to operations)

GUCCI

COLLECTION PORTFOLIO

- Gucci collection portfolio comprises:
  - 18,000 prototypes developed each year
  - 4,000 SKUs to be managed
- 90% of new articles each season
- Wide variety of materials, colours and accessories:
  - Not only trending stylists
  - ... but also 30 people in materials R&D

SUPPLY NETWORK

- Supply network comprises 600 firms
  - 70 tier 1 suppliers, 500+ second tier
  - based on Florence region
  - Gucci plans all material movements, but first tier suppliers control second tier
- Three categories of suppliers:
  - partners
  - integrated suppliers
  - others

The capability to manage in an "agile" way a wide supply network reaching the targets with a respect to a broad and often changed product offering … is surely a core competence!

Source: Cerruti and Harrison, Gucci case, 2005

Strategic decisions on competencies

Firms must identify their strengths and weaknesses in resources, capabilities, and core competencies.

Having a significant quantity of resources is not the same as having the “right” resources.

Tools such as outsourcing help the firm focus on its core competencies as the source of its competitive advantages.

Core competencies potentially might become CORE RIGIDITIES.

Outsourcing

- Outsourcing is the purchase of a value creating activity from an external supplier.
- By outsourcing activities in which it lacks competence, the firm can fully concentrate on those areas in which it can create value.
- Managers should have four skills:
  - strategic thinking,
  - deal making,
  - partnership governance,
  - and change management.

Business Process Outsourcing BPO

Business Process Outsourcing (BPO) a client's business process is performed by a vendor.

Certain business processes of the client are transferred over to the vendor (including some personnel of the company), and the vendor's office then becomes the "back office" for the client's outsourced business processes.

Examples: IT system management, call centers, emergency hotlines, claims management, helpdesks, data management, document processing and storage, financial services, payroll, auditing, accounting, travel management systems, various logistics and information systems services.

Reasons for outsourcing/BPO

Outsourcing is expected to contribute as to:

- **Focus on the core business**
- **Costs**

cost reduction (more often fixed cost reduction),, CapEx reduction

- **Flexibility**

Increase in service flexibility, effective peak-load management

- **Innovation**

Improvement in the service quality, speed in new services introduction, access to new competences/technologies

Risks in outsourcing/BPO

Outsourcing can be risky due :

- **Strategic/operational risks**

Loss of core competences, loss of control on the management of the business process, unreliability of the selected partner, lack of true cost advantages

- **Stakeholder negotiation**

Problems in re-training or re-allocating employees, labour law rigidities, trade unions reactions

- **Organization readiness**

Lack of standards in internal business processes, lack of experience with outsourcing contracts, lack of managerial competences to manage outsourcing

Buying competences and capabilities and competitive advantage

- The lack of key competencies or capabilities can be an important reason for an acquisition.
- Many acquisitions that Facebook (now Meta) did are mainly driven by a search for new competences and capabilities:
  - Instagram (Photo and video-sharing app; acquired on April 2012 for 1 Bil$)
  - Whatsapp (Mobile messenger service; acquired on February 2014 for 19 Bil$)
  - Oculus VR (Virtual Reality, acquired in 2014 for 2 Bil$)
  - Onavo (Mobile web analytics, acquired in October 2013 for 200 Mil$)
  - Beluga (Messaging service, acquired on March 2011 for undisclosed amount)

https://www.investopedia.com/articles/personal-finance/051815/top-11-companies-owned-facebook.asp

Resource integration and co-opetition

- Creating value by exploiting internal resources might not always ***maximize value creation***.
- ***Co-opetition*** is the value creating constellations in which market players cooperate or develop complementary products and simultaneously compete when it comes to value capture (Sony Play Station or UPS-DHL-FedEx)

https://hbr.org/2021/01/the-rules-of-co-opetition

- Resource integration helps avoid:
  - competence trap
  - lock-in effect

Capabilities and competitive advantage

- 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 Only when ***VRIN*** a capability can be source of competitive advantage.