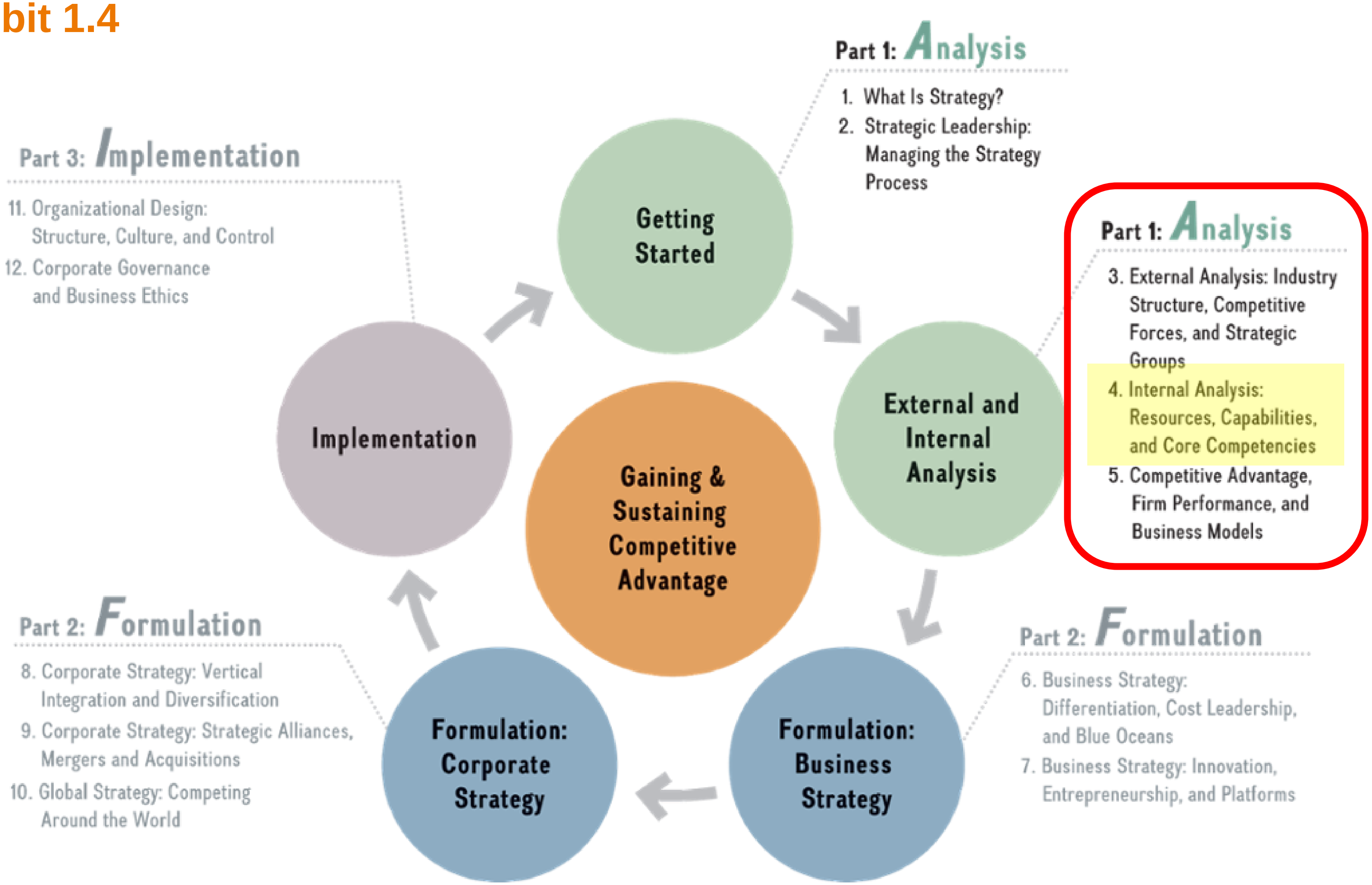
Internal Analysis

Strategic Management
SIB7501-B SEM1
Week 5
Dr. Sang-Bum Park
November 2022

AFI Strategy Framework

Exhibit 1.4



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Learning Objectives

- Explain how internal analysis of a firm can reveal why and how internal firm differences are the root of competitive advantage.
- Evaluate different conditions that allow a firm to sustain a competitive advantage.
- Evaluate the two critical assumptions about the nature of resources in the resource-based view.
- Apply the resource-based view and VRIO framework to assess competitive implications of a firm’s resources.

Opening Questions

How can a firm achieve superior performance than other firms in the same industry?

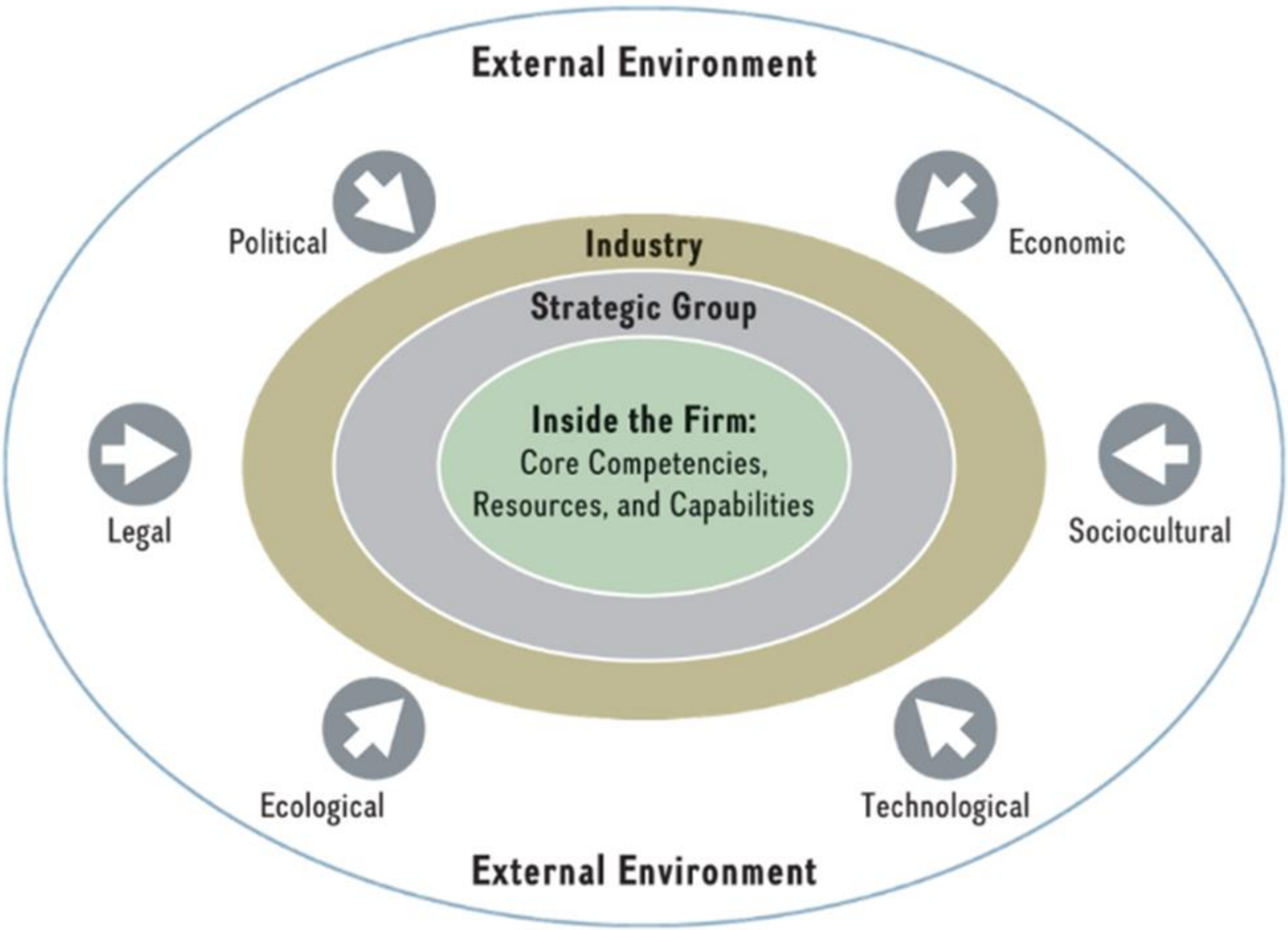
What stuffs do outstanding firms rely on to obtain their competitive advantage?

How can a firm sustain its competitive advantage over a long period of time?

Why do many firms that had succeeded once end up losing their competitive advantage?

Inside the Firm: Competitive Advantage

Exhibit 4.2

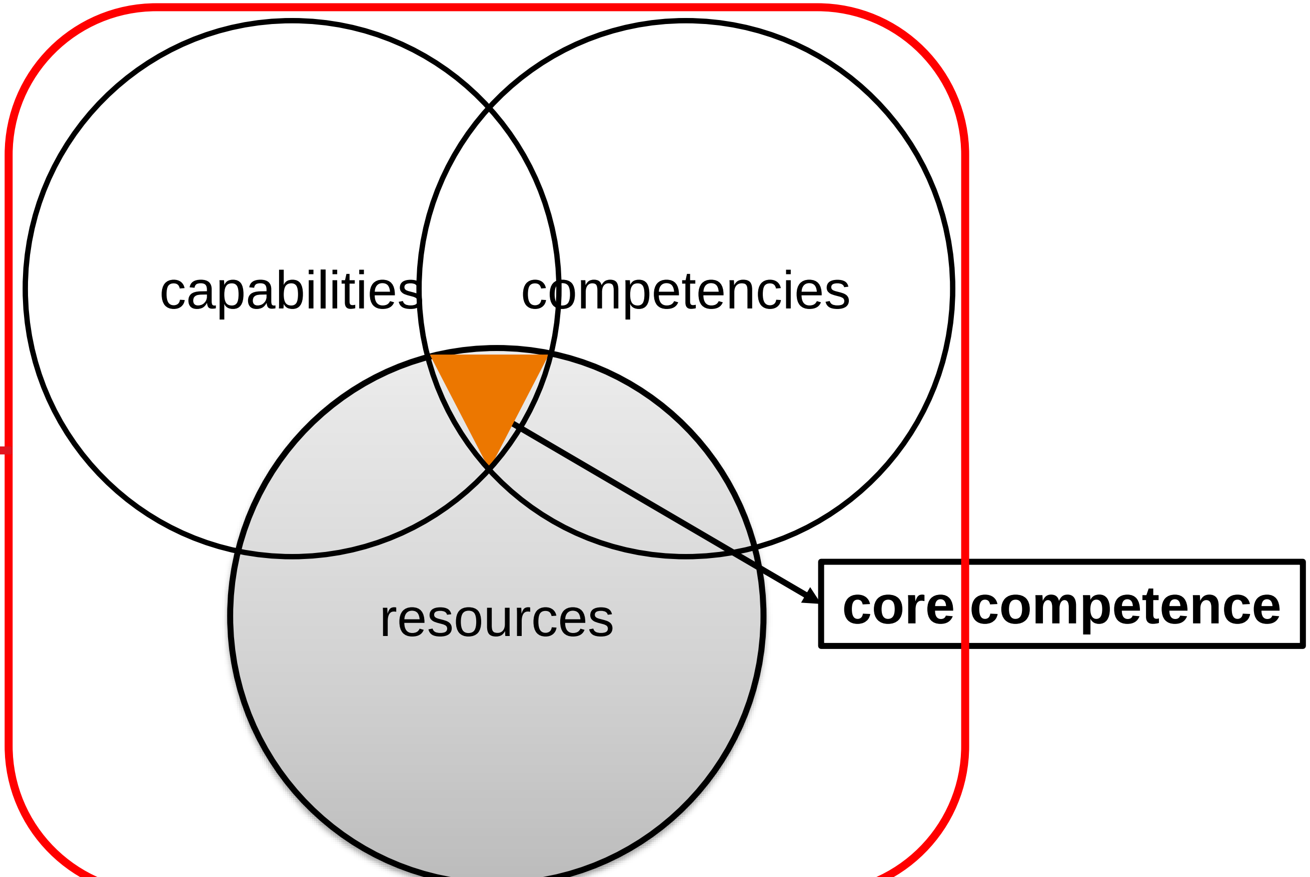


Resource-Based View

Key question:

***Under what conditions* do resources contribute to a firm's sustainable competitive advantage?**

Resources
In the RBV, resources include any capabilities and competencies that a firm can draw upon when formulating and implementing strategy



Some but not all resources and capabilities form the core competence of a firm.

Sustainable Competitive Advantage

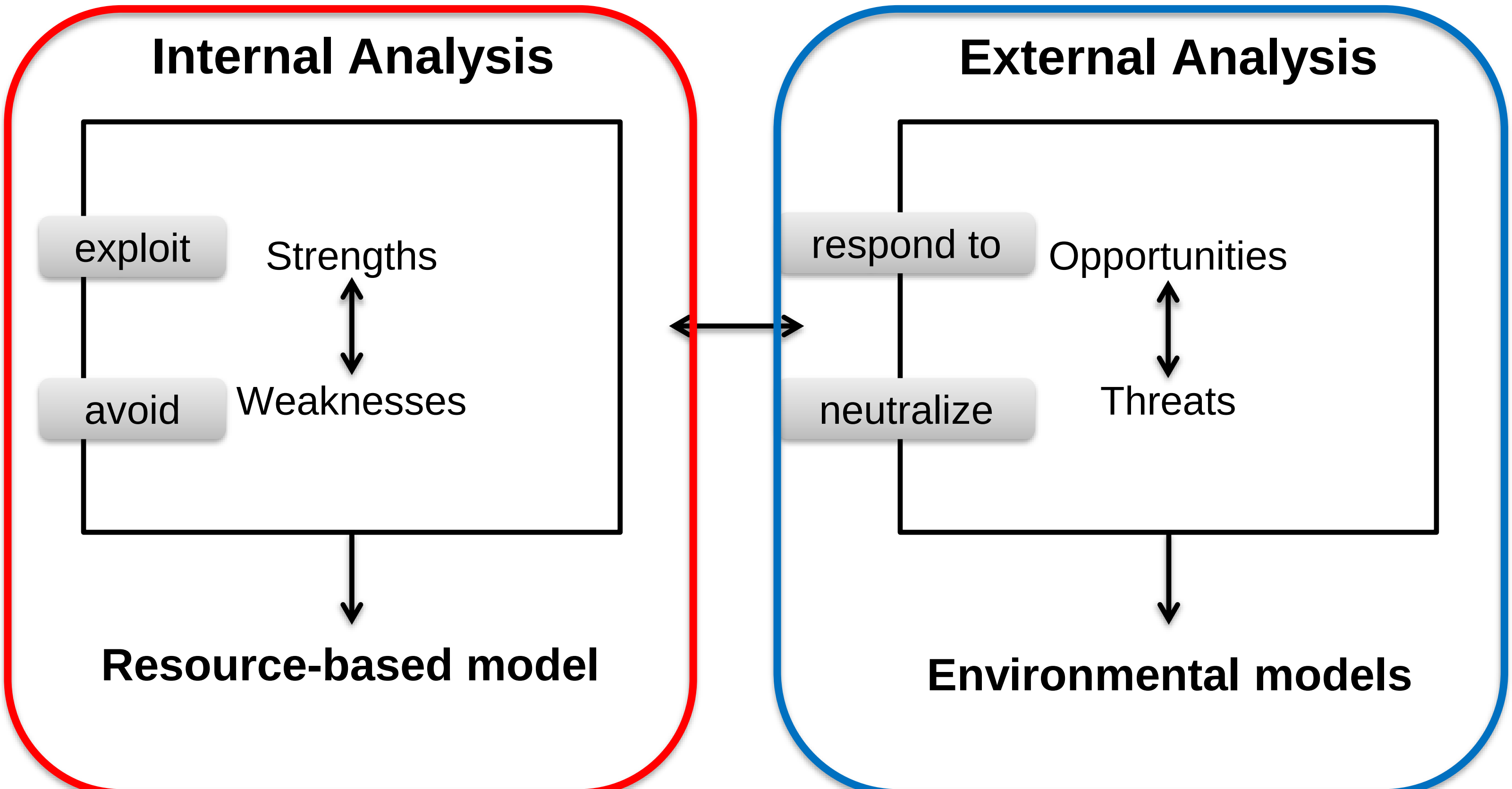
Strategy is a set of independent and integrated activities that enable a firm to achieve a sustainable competitive advantage.

temporary *competitive disadvantage or competitive parity*

- **Competitive advantage**: A firm outperforms its competitors in the same industry or the industry average.
- **Competitive parity**: Firms perform at the same level.
- **Competitive disadvantage**: A firm underperforms its rivals or the industry average.

SWOT analysis

To gain a sustainable competitive advantage, firms should have strategies that



Barney, 1991

Porter, 1979, 1980

Assumptions on Strategic Resources

Contrasting assumptions between FFM and RBV

	Resource homogeneity/ heterogeneity	Resource (im)mobility
Porter (1979, 1980)	Firms within an industry are identical in terms of strategic resources.	Firm resources are highly mobile in an industry, being bought and sold. Resource heterogeneity is very short lived.
Barney (1991)	Firms within an industry are heterogeneous in terms of strategic resources	Firm resources are not be perfectly mobile across firms. Resource heterogeneity can be long lasting.

Assumptions on Strategic Resources

Resource Heterogeneity

- A firm is a unique bundle of resources, capabilities, and competencies.
- These bundles differ across firms.

Resource Immobility

- Resources are "sticky," and don't move easily from firm to firm.
- Resources are difficult to replicate.
- Resources can last for a long time.

Internal Analysis of a Firm

To formulate a strategy that leads to a competitive advantage,

- Resources and capabilities must combine to form core competencies.
- Firms should consciously work to identify these.

Evaluation should occur in the context of PESTEL.

Evaluation should occur in the context of Competition.

- Use Porter’s Five Forces.
- Use the Strategic Group Map.

Internal Firm Differences Lead to Competitive Advantage

Strengths should be dynamic

- Adjust along with the external environment
- Dynamic capabilities

Strategically fit within the environment:

- Resources
- Capabilities
- Competencies

Core Competencies

Unique strengths

Embedded deep within a firm

Allow the firm to differentiate from rivals

- Result in creating **higher value** for the customer or
- Result in products and services offered at **lower cost**

Expressed through structures, processes, routines

Examples - Core Competencies

Five Guys FIVE GUYS

- Offers highest-quality ingredients, free toppings, simple menu

Beats Electronics

- Perception of coolness marketing

Tesla TESLA

- Engineering expertise in battery-powered motors & power trains

Netflix NETFLIX

- Creates proprietary algorithms based on individual customer preferences

Examples - Core Competencies

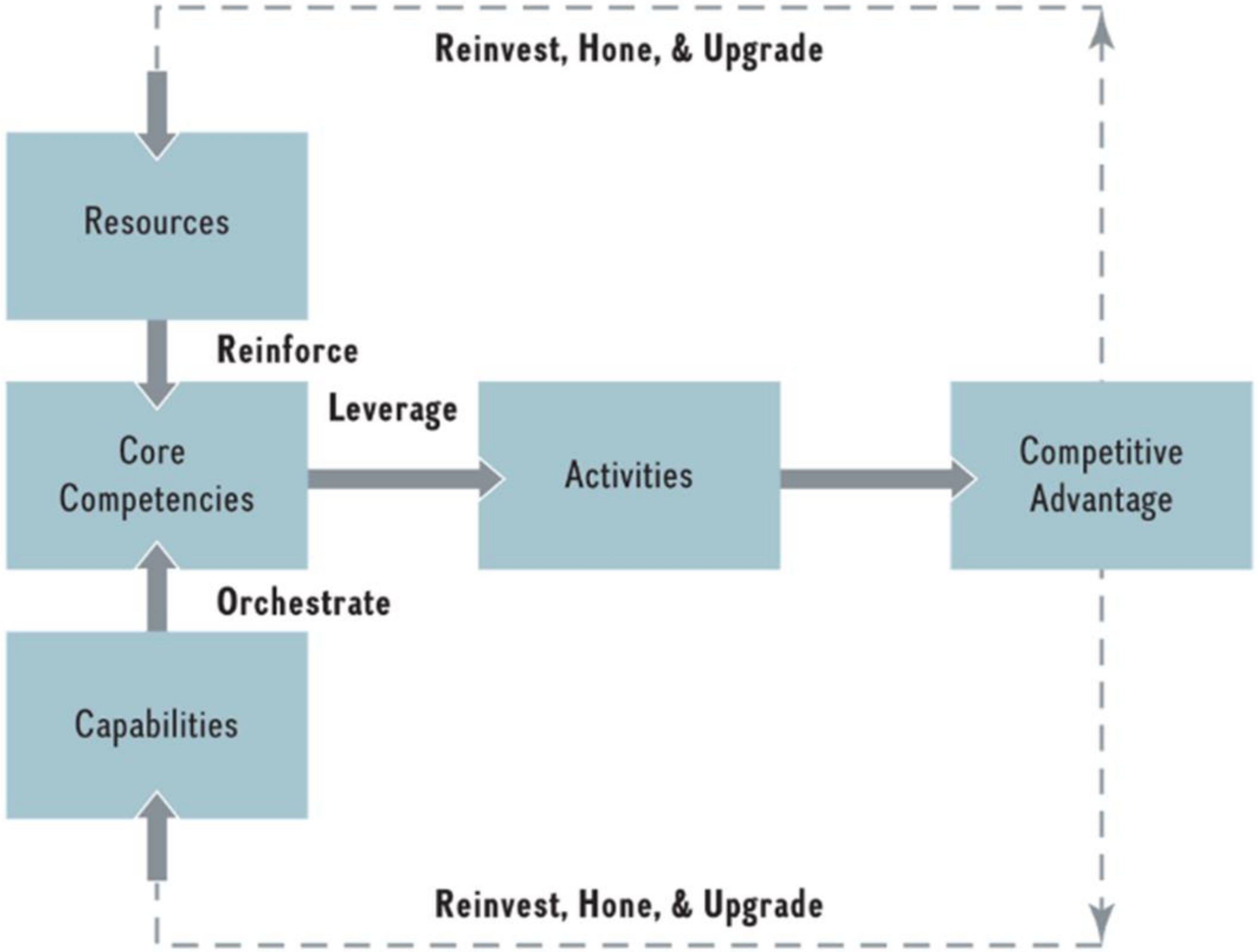
Company	Core Competencies	Application Examples
Amazon	• Superior IT and AI capabilities. • Superior customer service. • Diversification across different industries. • Establishing an ecosystem, combining hardware with software around its Amazon Echo platform.	• Online retailing: Largest selection of items online. • Full vertical integration in retail, from warehouse to delivery. • Cloud computing: Largest provider through Amazon Web Services (AWS).
Apple	• Superior industrial design in integration of hardware and software. • Superior marketing and retailing experience. • Establishing and maintaining an ecosystem of products and services that reinforce one another in a virtuous fashion.	• Creation of innovative and category-defining mobile devices and software services that take the user's experience to a new level (e.g., iMac, iPod, iTunes, iPhone, iPad, Apple Watch, Apple TV, Apple Pay, and Apple Card).
Coca-Cola Co.	• Superior marketing and distribution.	• Leveraging one of the world's most recognized brands (based on its original "secret formula") into a diverse lineup of soft drinks. • Global availability of products.

Examples - Core Competencies

Company	Core Competencies	Application Examples
Google (a subsidiary of Alphabet)	• Superior in creating proprietary algorithms based on large amounts of data collected online. • Superior AI capability.	• Software products and services for the internet and mobile computing, including some mobile devices (Pixel phone, Chromebook). • Online search, Android mobile operating system, Chrome OS, Chrome web browser, Google Play, AdWords, AdSense, Google docs, Gmail, etc.
IKEA	• Superior in designing modern functional home furnishings at low cost. • Superior retail experience.	• Fully furnished room setups, practical tools for all rooms, do-it-yourself.
McKinsey	• Superior in developing practice-relevant knowledge, insights, and frameworks in strategy.	• Management consulting; in particular, strategy consulting provided to company and government leaders.
Uber	• Superior mobile-app–based transportation and logistics expertise focused on cities, but on global scale.	• Uber, UberX, UberBlack, UberLUX, UberSUV, etc.

Linking Core Competencies, Resources, Capabilities, and Activities to Competitive Advantage

Exhibit 4.4



Resources, Capabilities and Activities

Help organizations develop core competencies

Resources

- Any assets that a firm can draw on
- Examples: cash, buildings, machinery, or intellectual property

Capabilities

- Organizational and managerial skills
- Examples: structure, routines, and culture

Activities

- Distinct and fine-grained business processes (order-taking, invoicing, etc.).

Resource-Based View

The Resource-Based View (RBV) was proposed by Jay Barney in his 1991 article.

- Barney, J. B. 1991. Firm resources and sustained competitive advantage. Journal of Management, 17: 99–120.

The VRIO framework was introduced by the same author in his textbook.

- Barney, J., & Hesterly, W. 2014. Strategic management and competitive advantage (5th ed.). Upper Saddle River, NJ: Pearson Prentice Hall.

Resource-Based View

This model aids in identifying core competencies.

- Resources are key to superior firm performance.

Resource:

- Assets, capabilities, and competencies.

Resources fall into two categories:

1. Tangible resources have physical attributes and are visible.
2. Intangible resources do not have physical attributes and are invisible.

Resource-Based View

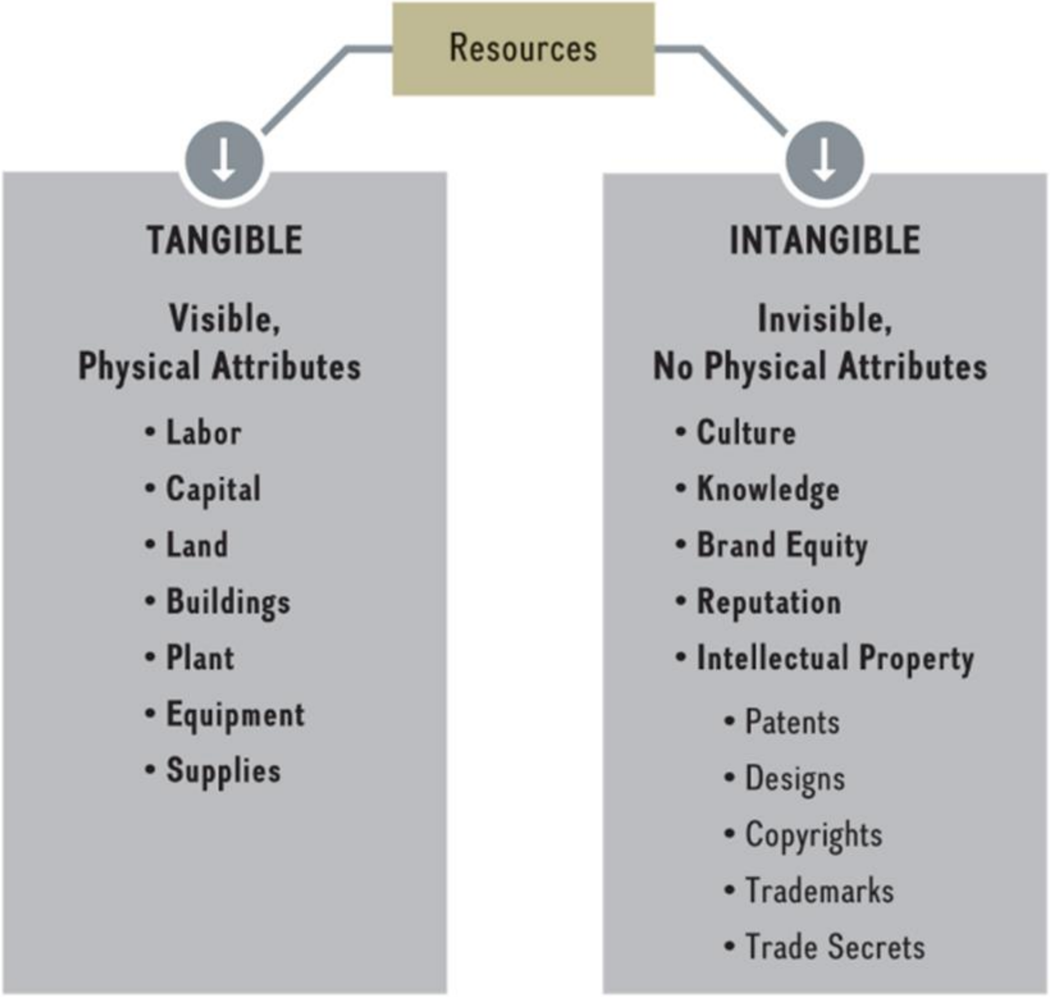
A sustainable competitive advantage

- Even if a firm is in an industry with a high profit potential if a firm does not have competitive resources, the firm’s competitive advantage can hardly be sustainable.

- Firm resources become a source of sustainable competitive advantage if it is valuable, rare, hard to duplicate and non-substitutable.

Tangible and Intangible Resources

Exhibit 4.5



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Types of Tangible Firm Resources

Tangible resources are assets that are relatively easy to identify.

- **Physical assets**: plant and facilities, location, machinery and equipment.
- **Financial assets**: cash and cash equivalents, borrowing capacity, capacity to raise equity.
- **Technological resources**: data analytic algorithms, patents, copyrights, trademarks.
- **Organizational resources**: effective planning processes, evaluation and control systems.

Types of Intangible Firm Resources

Intangible resources are difficult for competitors to account for or imitate. They are embedded in unique routines and practices.

- **Human resources**: trust, experience and capabilities of employees; managerial skills, firm specific practices and procedures.
- **Innovation resources**: technical and scientific expertise and ideas; innovation capabilities.
- **Reputation resources**: brand names, reputation for fairness with suppliers, non-zero sum relationships; reputation for reliability and product quality with customers.

Types of Firm Resources: Organizational Capabilities

Organizational capabilities are competencies or skills that a firm employs to transform inputs into outputs.

Capacity to combine tangible and intangible resources, using organizational processes to attain desired ends.

- Outstanding customer service
- Excellent product development capabilities
- Innovativeness of products and services, and flexibility in manufacturing processes
- Ability to hire, motivate, and retain human capital

VRIO Framework

VRIO is a tool for evaluating firm resource endowments.

- What resource attributes underpin competitive advantage?

To be the basis of a competitive advantage, a resource must be:

- Valuable.
- Rare.
- Costly to Imitate.
- Organized to capture the value of the resource.

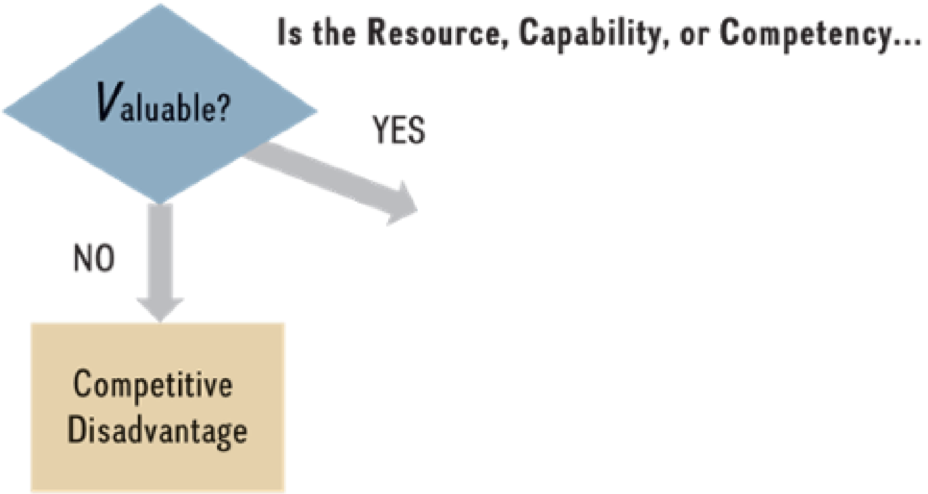
Jay Barney was a pioneer of this framework.

VRIO Framework

https://www.youtube.com/watch?v=TYCXZZmi8Qw

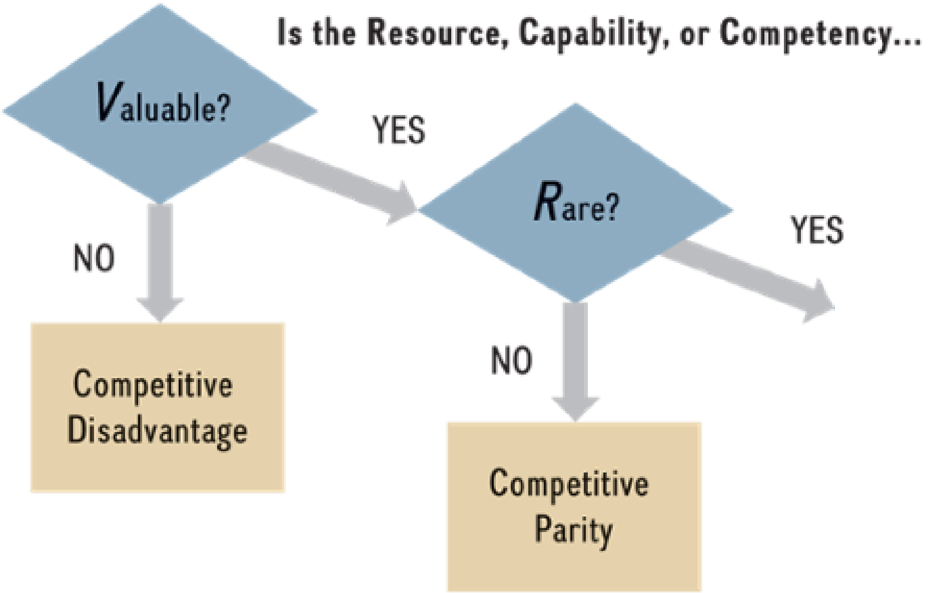
VRIO Framework

Exhibit 4.6



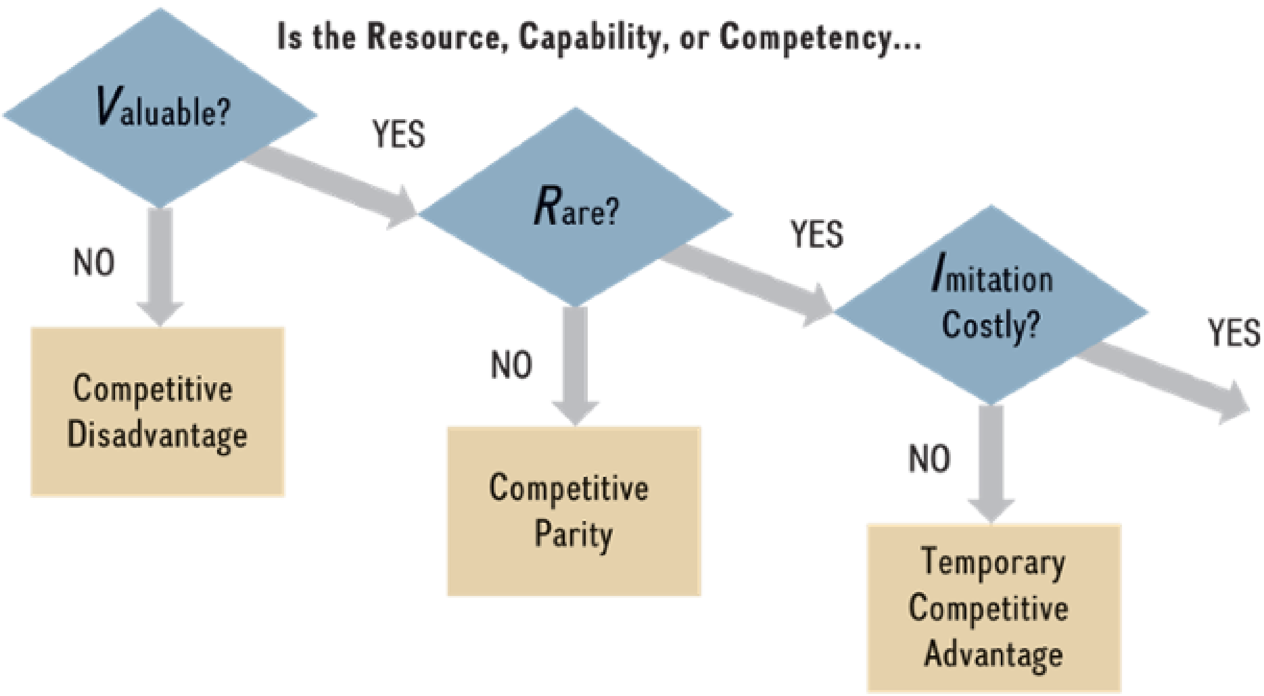
VRIO Framework

Exhibit 4.6



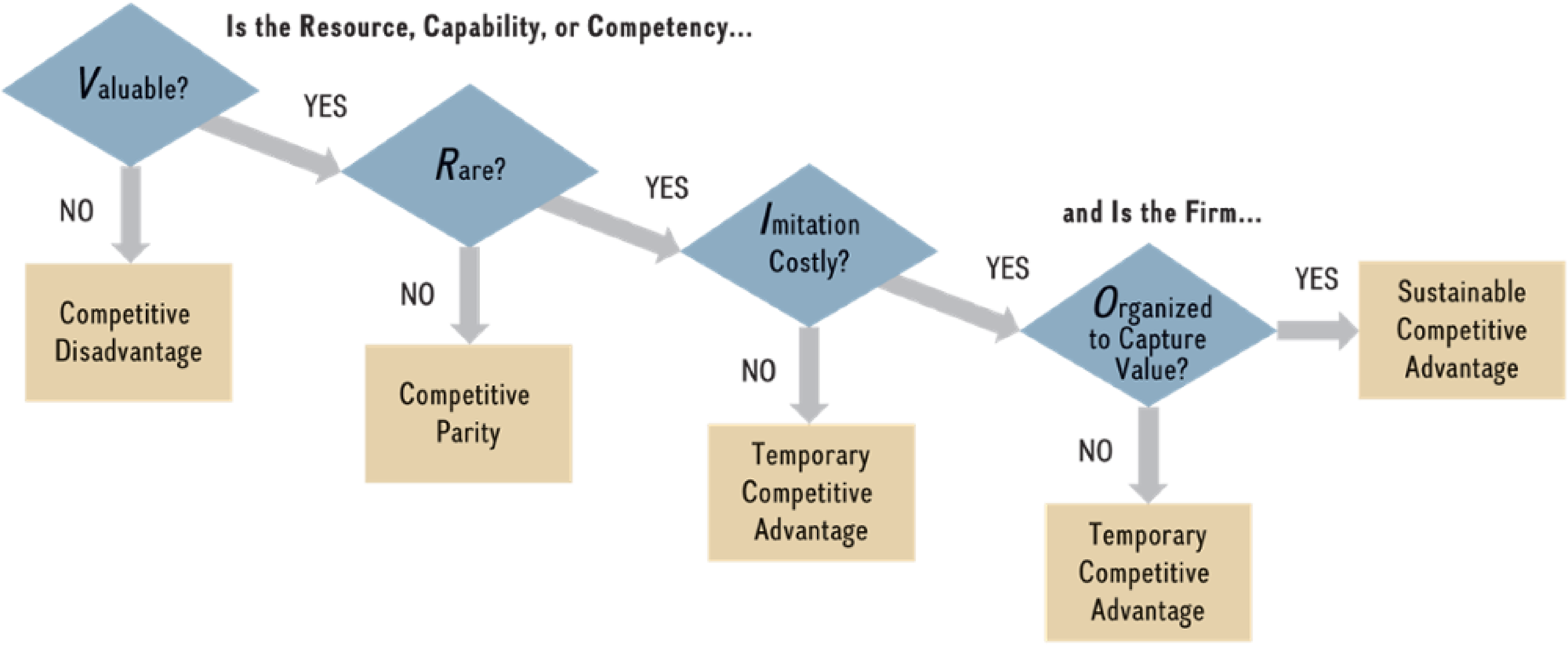
VRIO Framework

Exhibit 4.6



VRIO Framework

Exhibit 4.6



A Resource Is…

Valuable if:

- It helps to exploit an opportunity or offset a threat.

Rare if:

- Only one or a few firms possess it.

Costly to Imitate if:

- Competitors can’t develop the resource for a reasonable price.
- Imitation and substitution are risks.

The firm is organized to capture value through:

- Effective internal organizational structure and coordinating systems.

Case – Xerox's Palo Alto Research Center

A case not organized well to capture value from resources

Before Apple or Microsoft had any significant share of the personal computer market, Xerox's Palo Alto Research Center (PARC) invented and developed an early word-processing application, the graphical user interface (GUI), the Ethernet, the mouse as a pointing device, and even the first personal computer. These technology breakthroughs laid the foundation of the desktop-computing industry.[23] Xerox's invention competency built through a unique combination of resources and capabilities was clearly valuable, rare, and costly to imitate with the potential to create a competitive advantage.

Due to a lack of appropriate organization, however, Xerox failed to appreciate and exploit the many breakthroughs made by PARC in computing software and hardware. Why? Because the innovations did not fit within the Xerox business focus at the time. Under pressure in its core business from Japanese low-cost competitors, Xerox's top management was busy pursuing innovations in the photocopier business. Xerox was not organized to appreciate the competitive potential of the valuable, rare, and inimitable resources generated at PARC, if not in the photocopier field. Such organizational problems were exacerbated by geography: Xerox headquarters is on the East Coast in Norwalk, Connecticut, across the country from PARC on the West Coast in Palo Alto, California.[24] Nor did it help that development engineers at Xerox headquarters had a disdain for the scientists engaging in basic research at PARC. In the meantime, both Apple and Microsoft developed operating systems, graphical user interfaces, and application software.

If a firm is not effectively organized to exploit the competitive potential of a valuable, rare, and costly-to-imitate (VRI) resource, the best-case scenario is a temporary competitive advantage (see **Exhibit 4.6**). In the case of Xerox, where management was not supportive of the resource, even a temporary competitive advantage would not be realized even though the resource meets the VRI requirements.

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Isolating Mechanisms

Barriers to imitation.

Helps sustain a competitive advantage.

- Better expectations of future resource value.
- **Path dependence**: past decisions limit current options.
- **Causal ambiguity**: cause and effect are vague.
- **Social complexity**: social and business systems interact.
- Intellectual property (IP) protection.

Resource Inimitability

Firm resources can be imperfectly imitable for one or a combination of three reasons:
(a) The ability of a firm to obtain a resource is dependent upon **unique historical conditions**,
(b) The link between the resources possessed by a firm and a firm's sustained competitive advantage is **causally ambiguous**, or
(c) the resource generating a firm's advantage is **socially complex**
(Barney, 1991: 107)

Unique Historical Condition

Read the following part and think about examples.
Then, discuss with colleagues sitting next to you.

Unique historical conditions and imperfectly imitable resources. Another assumption of most environmental models of firm competitive advantage, besides resource homogeneity and mobility, is that the performance of firms can be understood independent of the particular history and other idiosyncratic attributes of firms (Porter, 1981; Scherer, 1980). These researchers seldom argue that firms do not vary in terms of their unique histories, but rather that these unique histories are not relevant to understanding a firm's performance (Porter, 1980).

The resource-based view of competitive advantage developed here relaxes this assumption. Indeed, this approach asserts that not only are firms intrinsically historical and social entities, but that their ability to acquire and exploit some resources depends upon their place in time and space. Once this particular unique

Barney (1991: 107-108)

Causal Ambiguity

Read the following part and think about examples. Then, discuss with colleagues sitting next to you.

Causal ambiguity and imperfectly imitable resources. Unlike the relationship between a firm's unique history and the imitability of its resources, the relationship between the causal ambiguity of a firm's resources and imperfect imitability has received systematic attention in the literature (Alchian, 1950; Barney, 1986b, Lippman & Rumelt, 1982; Mancke, 1974; Reed and DeFillippi, 1990; Rumelt, 1984). In this context, causal ambiguity exists when the link between the resources controlled by a firm and a firm's sustained competitive advantage is not understood or understood only very imperfectly.

Barney (1991: 108-110)

Social Complexity

Read the following part and think about examples.
Then, discuss with colleagues sitting next to you.

Social complexity. A final reason that a firm's resources may be imperfectly imitable is that they may be very complex social phenomena, beyond the ability of firms to systematically manage and influence. When competitive advantages are based in such complex social phenomena, the ability of other firms to imitate these resources is significantly constrained.

A wide variety of firm resources may be socially complex. Examples include the interpersonal relations among managers in a firm (Hambrick, 1987), a firm's culture (Barney, 1986b), a firm's reputation among suppliers (Porter, 1980) and customers (Klein, Crawford & Alchian, 1978; Klein & Lefler, 1981). Notice that in most of these cases it is possible to specify how these socially complex resources add value to a firm. Thus, there is little or no causal ambiguity surrounding the link between these firm resources and competitive advantage. However,

Barney (1991: 110-111)

Causal Ambiguity and Social Complexity

Difference between causal ambiguity and social complexity

	Inimitability	Means-ends link
causal ambiguity	*high*	*unclear*
Social complexity	*high*	*clear*

Application of VRIO Framework

Positive reputation can be a source of sustainable competitive advantage when it is

- Valuable
- Rare
- Imperfectly imitable or costly-to-imitate
- Non substitutable

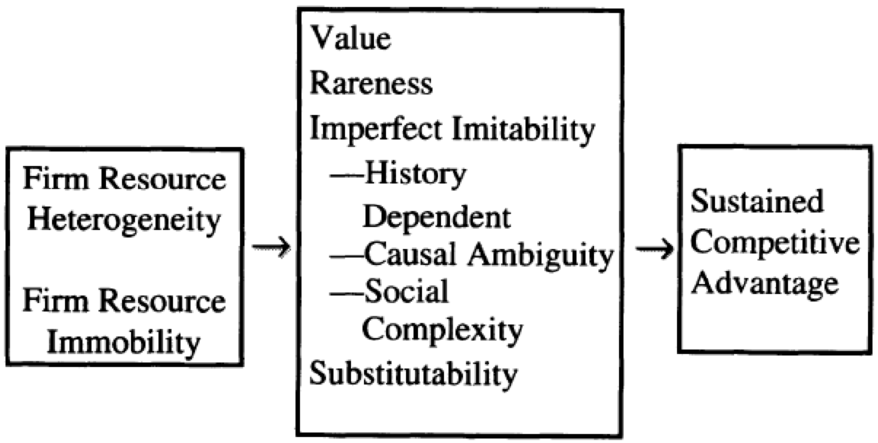


Figure Two. The Relationship Between Resource Heterogeneity and Immobility, Value, Rareness, Imperfect Imitability, and Substitutability, and Sustained Competitive Advantage.

Barney (1991: 112)

Application of VRIO Framework

Read the following paragraphs (Barney, 1991: 115). Then, discuss with colleagues sitting next to you.

Positive Reputations and Sustained Competitive Advantages

Positive reputations of firms among customers and suppliers have also been cited as sources of competitive advantage in the literature (Porter, 1980). An application of the framework presented in Figure Two, again, suggests the conditions under which a firm's positive reputation can be a source of sustained competitive advantage. If only a few competing firms have such reputations, then they are rare. In general, the development of a positive reputation usually depends upon specific, difficult-to-duplicate historical settings. To the extent that a particular firm's positive reputation depends upon such historical incidents, it may be imperfectly imitable. In addition, positive firm reputations can be thought of as informal social relations between firms and key stakeholders (Klein & Leffler, 1981). Such informal relations are likely to be socially complex, and thus imperfectly imitable.

The question of substitutes for a positive reputation is, again, more complicated. Some authors (Klein, Crawford, & Alchian, 1981) have suggested that rather than developing a positive reputation, firms may reassure their customers or suppliers through the use of guarantees and other long-term contracts. Thus, these guarantees substitute for a firm's reputation. However, it is not clear that the implicit psychological contract between a firm and its stakeholders when a firm has a positive reputation is the same as the implicit psychological contract between a firm and its stakeholders when a firm uses guarantees for reassurance. If, in fact, reputation and guarantees are substitutes, why is it that some firms invest both in a positive reputation and guarantees? If these two firm resources are not substitutes, then a reputation (if it is rare and imperfectly imitable) may be a source of sustained competitive advantage.

Barney (1991: 115)

Core Rigidity

A former core competency turned into a liability.

- Result of an environmental change.
- No longer fits the external environment.

Turns a resource from an asset to a liability.

- Causes loss of competitive advantage.
- The firm may even go out of business.

Dynamic Capabilities

A firm's ability to:

- Adapt resources over time.
- Create, deploy, modify, reconfigure, upgrade, leverage.

The goal:

- Create long-term competitive advantage.
- Develop resources, capabilities and competencies.
- Create a strategic fit with the firm's environment.
- Change in a dynamic fashion.

The Dynamic Capabilities Perspective

A model that emphasizes a firm’s ability to:

- Modify and leverage its resource base.
- Gain and sustain competitive advantage.
- Respond to a constantly changing environment.

Dynamic markets are due to:

- Technological change, deregulation, globalization, demographic shifts.

Resources are created, deployed, modified, reconfigured, or upgraded.

Resource Stocks and Flows

A way to think about developing dynamic capabilities.

Resource stocks:

- The firm's current level of intangible resources.
- New product development, engineering expertise, innovation capability.

Resource flows:

- The firm's level of investments to maintain or build a resource.

The Bathtub Metaphor

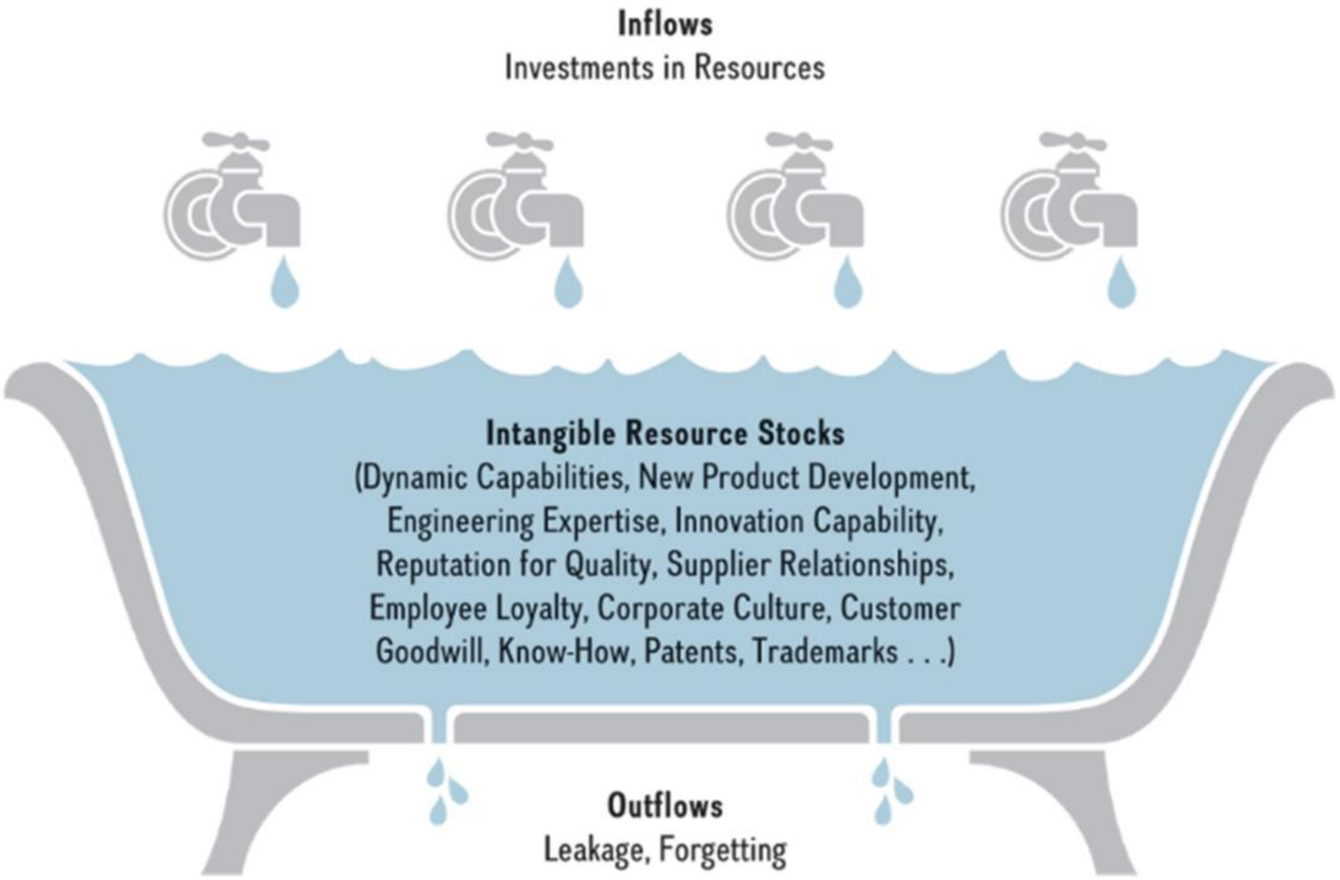


Exhibit 4.7

SOURCE: Figure based on metaphor used in I. Dierickx and K. Cool (1989), “Asset stock accumulation and sustainability of competitive advantage,” *Management Science* 35: 1504–1513.

Access the text alternative for slide images.

The Value Chain

Internal activities a firm engages in when transforming inputs into outputs.

- Through primary and support activities.

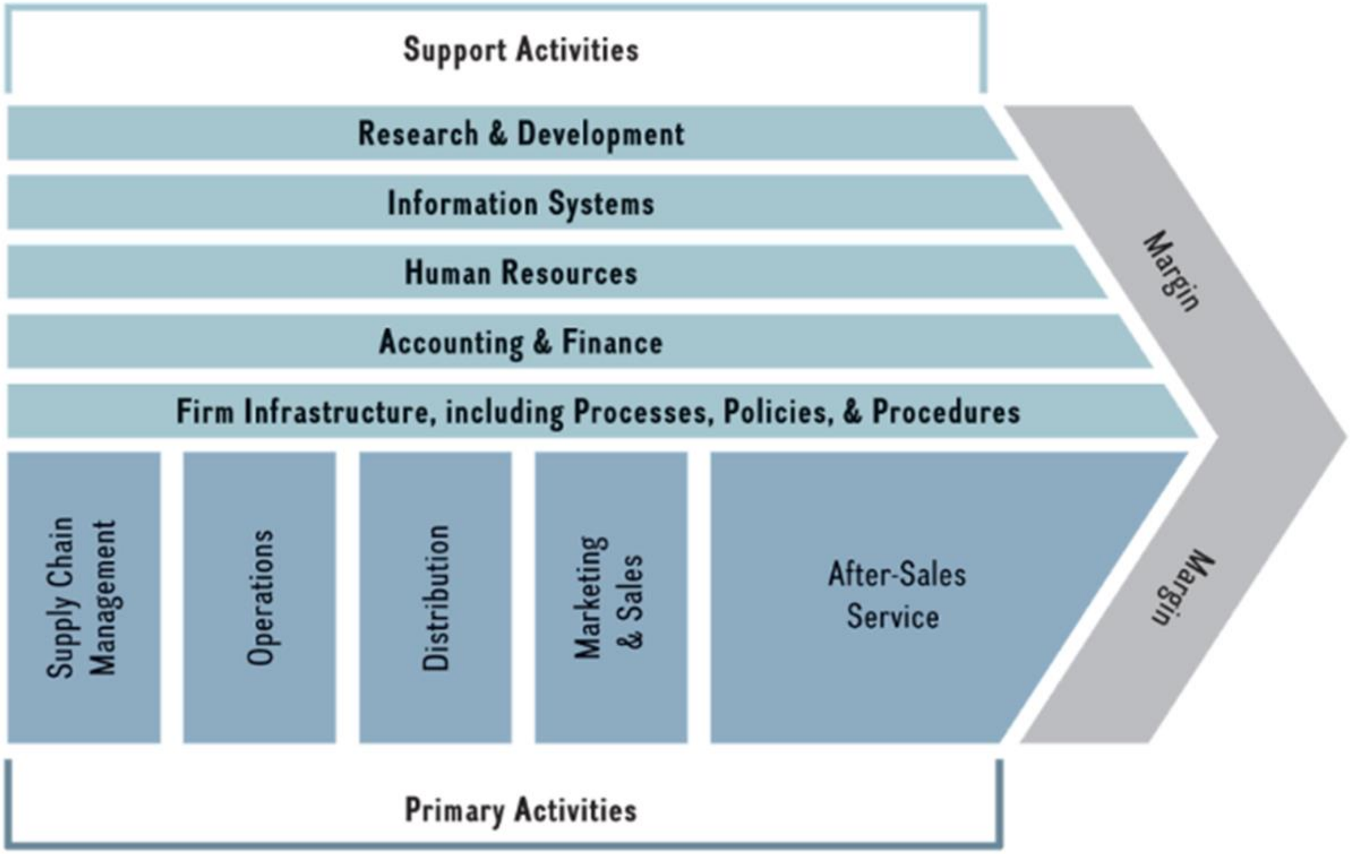
Each activity adds incremental value.

- Raw materials -> components -> products

Each activity also adds incremental costs.

A Generic Value Chain

Exhibit 4.8



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Primary Activities

Firm activities add value directly.

Transform inputs into outputs.

Focused on moving from raw materials, through production phases, to sales and marketing, and finally customer service.

- Supply chain management.
- Operations.
- Distribution.
- Marketing and sales.
- After-sales service.

Support Activities

Firm activities that add value indirectly.

Necessary to sustain primary activities.

- Research and development (R&D).
- Information systems.
- Human resources.
- Accounting and finance.
- Firm infrastructure including processes, policies, and procedures.

Strategic Activity Systems

A network of interconnected activities:

- Can be the foundation of competitive advantage.
- Socially complex and causally ambiguous.
- Enhance likelihood of sustained competitive advantage.

Characteristics:

- One or more elements can be easily observed.
- How activities are managed is not as easily observed.
- Difficult to imitate.

Strategic Activity Systems Must Evolve

External environment changes.

Competitors develop their activity systems.

How activity systems are updated:

- Add new activities.
- Remove activities that are no longer relevant.
- Upgrade activities that have become stale or somewhat obsolete.

This reconfigures the entire strategic activity system.

The Vanguard Group's Activity System - 1997

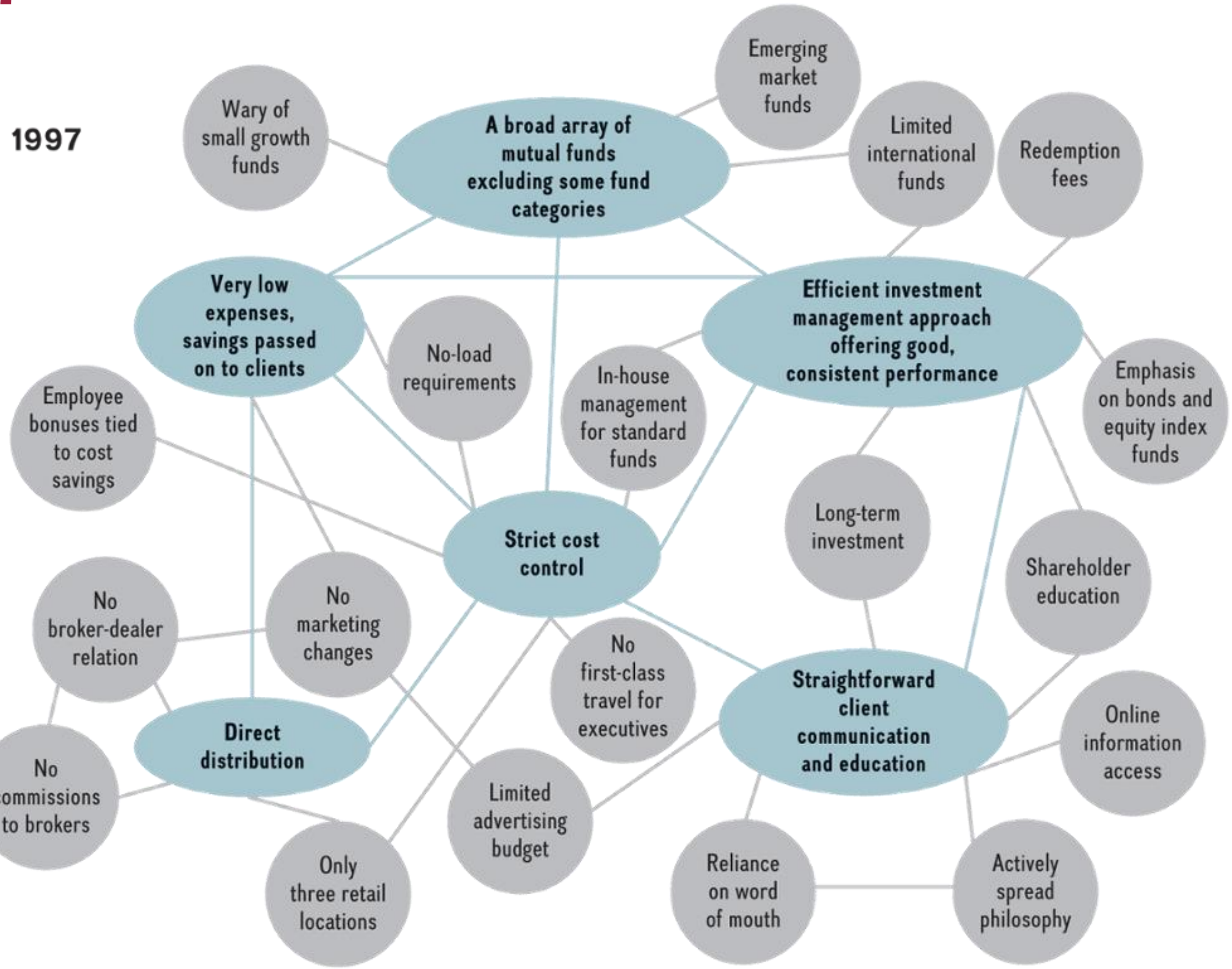

Exhibit 4.9

Source: Adapted from N. Siggelkow (2002), "Evolution toward fit," *Administrative Science Quarterly* 47: 146.

The Vanguard Group's Activity System - 2019

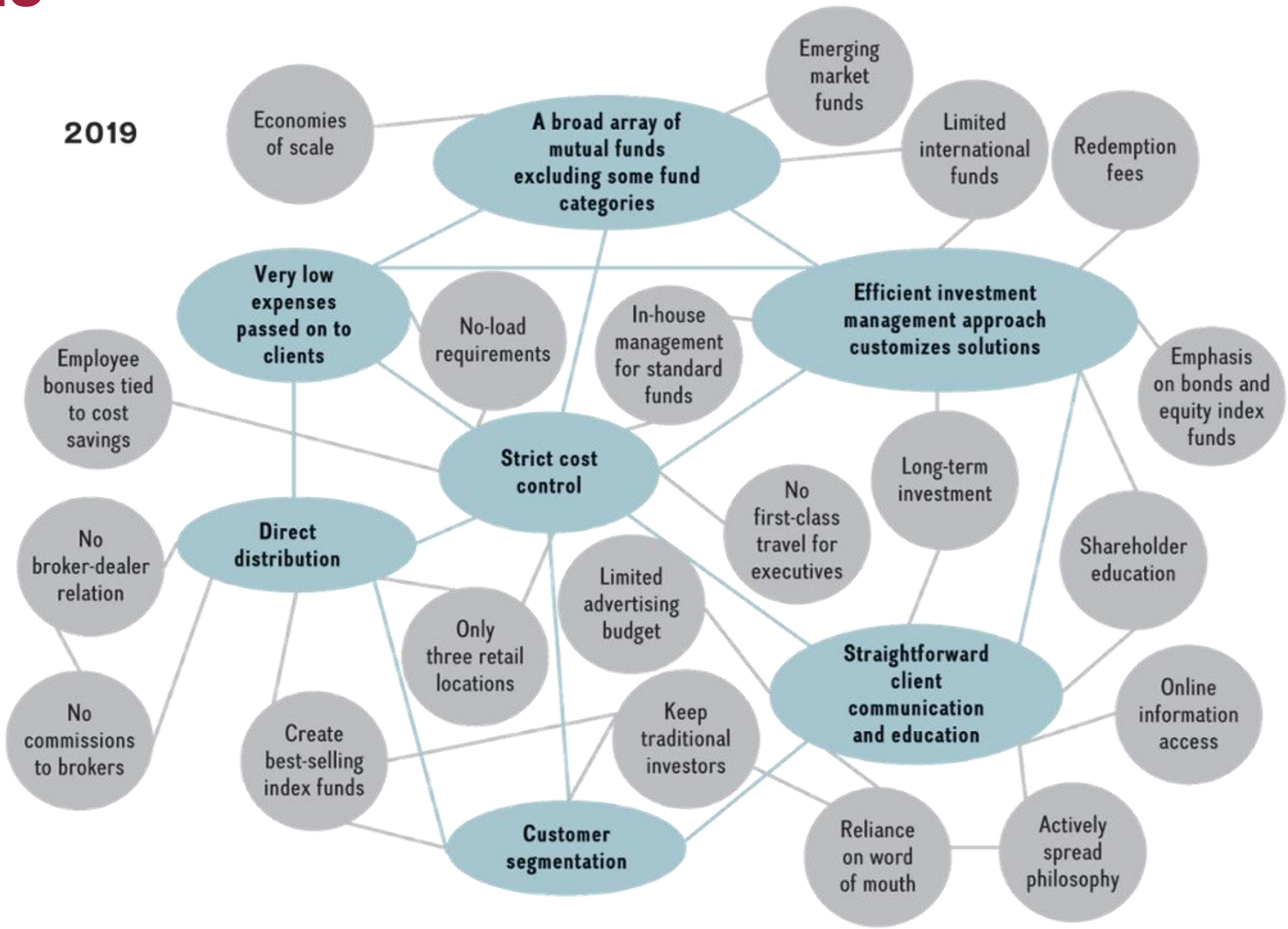

Exhibit 4.10

Q&As