10TH EDITION EXPLORING STRATEGY

The Strategic Position
3: Strategic Capabilities

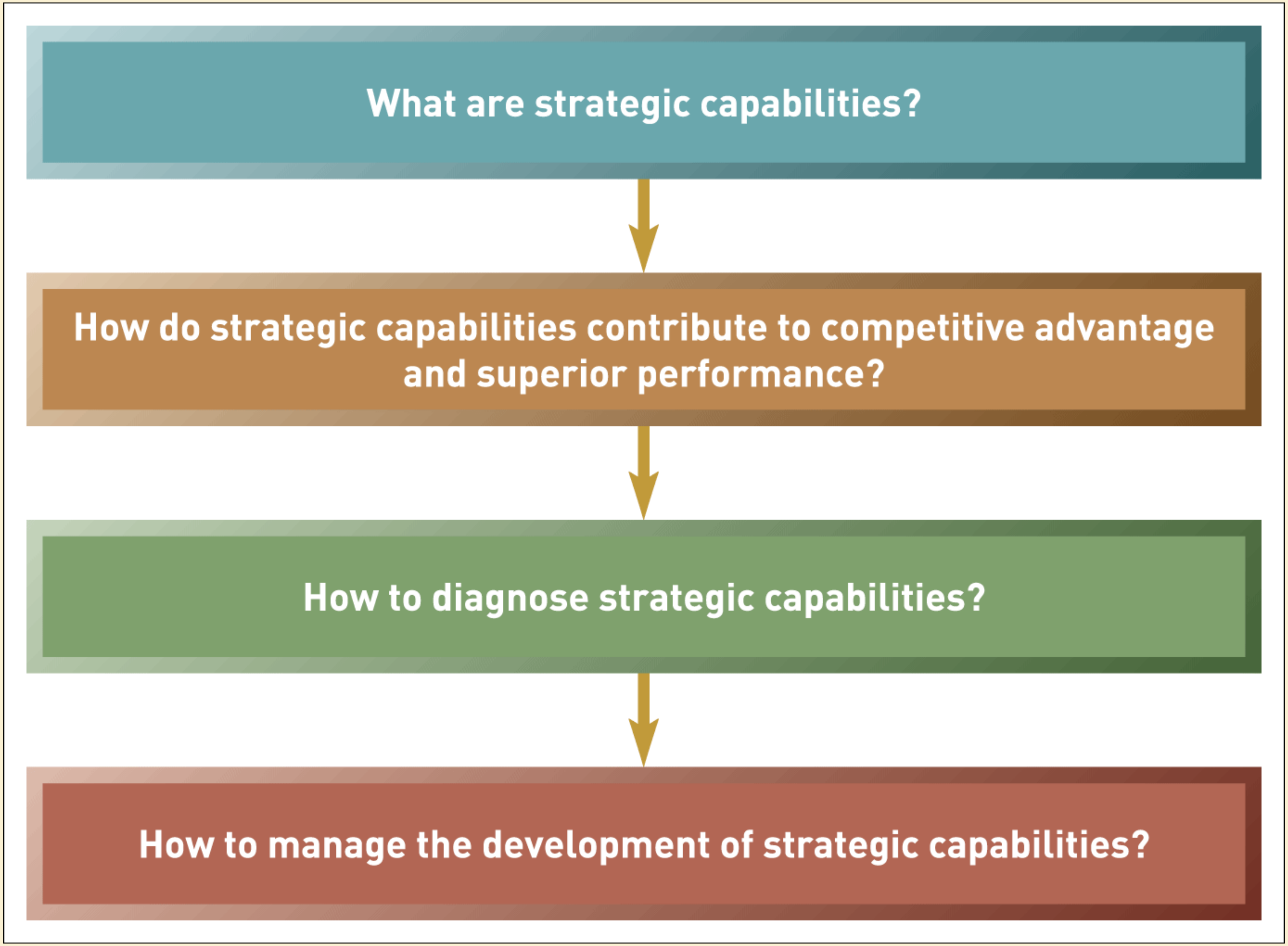
The Strategy Checklist

Strategic position	Strategic choices	Strategy in action
• What are the environmental opportunities and threats? • What are the organisation's strengths and weaknesses? • What is the basic purpose of the organisation (e.g. mission, vision, objectives)? • How does culture fit the strategy?	• How should business units compete (e.g. cost leadership vs. differentiation)? • Which businesses to include in a portfolio (e.g. diversification)? • Where should the organisation compete internationally? • Is the organisation innovating appropriately in its current products/ markets? • Should the organisation buy other companies, ally or go for it alone?	• Are strategies suitable, acceptable and feasible? • What kind of strategy-making process is needed? • What are the required organisation structures and systems? • How should the organisation manage necessary changes? • Who should do what in the strategy process?

Learning outcomes

- Identify ***strategic capabilities*** in terms of organisational ***resources*** and ***competences*** and how these relate to the strategies of organisations.
- Analyse how strategic capabilities might provide sustainable competitive advantage on the basis of their ***Value***, ***Rarity***, ***Inimitability*** and ***Organisational support (VRIO)***.
- Diagnose strategic capability by means of ***VRIO analysis***, ***benchmarking***, ***value chain analysis*** and ***SWOT analysis***.
- Consider how managers can ***develop strategic capabilities*** for their organisations.

Strategic capabilities: the key issues



Resource-based strategy view

The resource-based view (RBV) of strategy asserts that the competitive advantage and superior performance of an organisation are explained by the distinctiveness of its capabilities. It is sometimes also called the 'capabilities view'.

That is, it is not only the external environment that matters for strategy. For example, manufacturers of saloon cars compete within the same industry and within the same technological environment, but with markedly different success. BMW has been relatively successful consistently; Ford and Chrysler have found it more difficult to maintain their competitive position. And others, such as Rover in the UK and SAAB in Sweden have gone out of business (though the brands may have been acquired by others). These differences in performance can be explained by differences in their company-specific strategic capabilities.

*Note: Chrysler was acquired by Fiat, Jaguar Land Rover was acquired by the Indian Tata, SAAB does not exist

Resources and competences

- ***Strategic capabilities*** are the capabilities of an organisation that contribute to its long-term survival or competitive advantage.
  - ***Resources*** are the assets that organisations have or can call upon (e.g. from partners or suppliers), that is ***'what we have'***.
  - ***Competences*** are the ways those assets are used or deployed effectively, that is ***'what we do well'*** .

Strategic capability

Resources: what we have (nouns), e.g.		Competences: what we do well (verbs), e.g.
Machines, buildings, raw materials, products, patents, databases, computer systems	Physical	Ways of achieving utilisation of plant, efficiency, productivity, flexibility, marketing
Balance sheet, cash flow, suppliers of funds	Financial	Ability to raise funds and manage cash flows, debtors, creditors, etc.
Managers, employees, partners, suppliers, customers	Human	How people gain and use experience, skills, knowledge, build relationships, motivate others and innovate

Long-term survival and competitive advantage

Ordinary and dynamic capabilities

Ordinary capabilities are the capabilities necessary to operate efficiently now (e.g. owning certain tangible assets, controlling costs, maintaining quality etc.) but may not be sufficient to sustain superior performance in the future.

Dynamic capabilities are the means by which an organisation has the ability to renew and recreate its strategic capabilities to meet the needs of changing environments. They are dynamic in the sense that they can create, extend or modify an organization's existing operational capabilities.

The following generic types of dynamic capabilities exist:

- *Sensing capabilities* – constantly scanning and exploring new opportunities across markets and technologies (e.g. R & D and market research)
- *Seizing capabilities* – addressing opportunities through new products, processes and activities
- *Re-configuring capabilities* – new products and processes may require renewal and re-configuration of capabilities and investment in new technologies.

Examples of dynamic capabilities are new product development (R&D) and strategic planning. They both involve activities that can sense and seize opportunities and also reconfigure capabilities.

Threshold and distinctive capabilities

- ***Threshold capabilities*** are those needed for an organisation to meet the necessary requirements to compete in a given market and achieve parity with competitors in that market – ***'qualifiers'***.
- ***Distinctive capabilities*** are those that are required to achieve competitive advantage. Distinctive or unique capabilities that are of value to customers and which competitors find difficult to imitate – ***'winners'***.
  - Example of a distinctive resource is a long established brand
  - Example of a distinctive competency is the building of excellent relations with retailers. Distinctive competencies are typically more difficult for competitors to match. Distinctive competencies are also referred to as core competencies (i.e. ***linked sets*** of skills, activities and resources, which typically remain unique because of their inter-linking).

	Resources	Competences
Threshold capabilities Required to be able to compete in a market	Threshold resources	Threshold competences
Distinctive capabilities Required to achieve competitive advantage	Distinctive resources	Distinctive competences

Strategic capabilities and competitive advantage

The four key criteria by which capabilities can be assessed in terms of providing a basis for achieving ***sustainable*** competitive advantage are:

- ***value***
- ***rarity***
- ***inimitability and***
- ***organisational support***

VRIO

V	**Value:** Do capabilities exist that are valued by customers and enable the organisation to respond to environmental opportunities or threats?
R	**Rarity:** Do capabilities exist that no (or few) competitors possess?
I	**Inimitability:** Are capabilities difficult and costly for competitors to obtain and imitate?
O	**Organisational support:** Is the organisation appropriately organised to exploit the capabilities?

VRIO: Value and Rarity

V – Value of strategic capabilities

Strategic capabilities are of value when they:

- take advantage of opportunities and neutralise threats (e.g. IKEA's cost-conscious culture, size and interlinked activities lower its costs vs. competitors and addresses opportunities of low-priced furniture)
- provide value to customers
- are provided at an appropriate cost that still allows an organisation to make an acceptable return.

R – Rarity

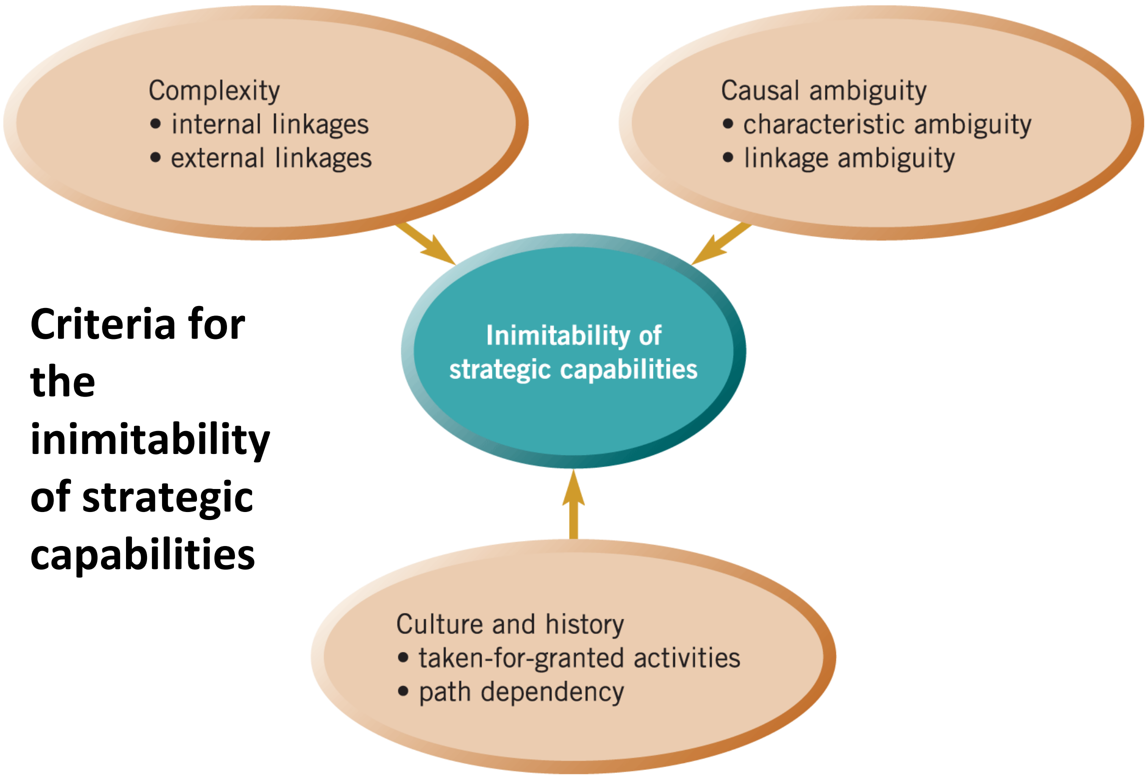
- Rare capabilities are those possessed uniquely by one organisation or only by a few others (e.g. a company may have patented products, have supremely talented people or a powerful brand).
- Rarity could be temporary.

  (E.g. Patents expire, key individuals can leave or brands can be de-valued by adverse publicity.)

VRIO: Inimitability

Inimitable capabilities are those that competitors find difficult and costly to imitate, to obtain or to substitute.

- Competitive advantage can be built on unique resources (a key individual or IT system) but these may not always be sustainable (key people leave or others acquire the same systems).
- Sustainable advantage is more often found in competences (the way resources are managed, developed and deployed) and the way competences are linked together and integrated.



Criteria for the inimitability of strategic capabilities

- **Internal linkages example**: linked activities and processes of Ryanair
- **External linkages example**: managing activities for customers
- **Characteristic ambiguity**: characteristic based on tacit knowledge (e.g. knowledge of customers)
- **Linkage ambiguity**: competitor cannot discern which activities are linked
- **Taken-for-granted activities**: they occur 'naturally', having evolved over the years (may not be recorded)
- **Path dependency**: origins and history by which competences have developed

VRIO: Organisational support & competitive implications

O – Organisational support

The organisation must be suitably organised to support and facilitate the exploitation of the valuable, rare and inimitable capabilities that it has. This includes appropriate processes and systems.

Competitive implications

Is the capability . . .

valuable?	rare?	inimitable?	supported by the organisation?	Competitive implications
No	–	–	No	Competitive disadvantage
Yes	No	–	↕	Competitive parity
Yes	Yes	No		Temporary competitive advantage
Yes	Yes	Yes	Yes	Sustained competitive advantage

Organisational knowledge

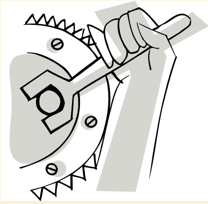
Organisational knowledge is organisation-specific, collective intelligence, accumulated through both formal systems and people’s shared experience. Sharing this knowledge across the organization is extremely important and also challenging.

Organizational knowledge presents a good example of how both resources and competencies may combine to produce competitive advantage.

Organizational knowledge can be distinguished into:

- ***‘Explicit’ knowledge*** or ‘objective’ knowledge in explicit form which is transmitted in formal systematic ways, e.g. systems manuals or market research.
- ***‘Tacit’ knowledge*** is more personal, context-specific, hard to formalise and communicate (resides in the heads of people) and is difficult to imitate, e.g. the knowledge and relationships in a top R&D team.

Case study exercise



- Read the case study “Groupon and the sincerest form of flattery”

- Answer the questions included at the end of the case study

Diagnosing strategic capabilities: Benchmarking

Benchmarking is a means of understanding how an organisation compares with others – typically competitors.

Two approaches to benchmarking:

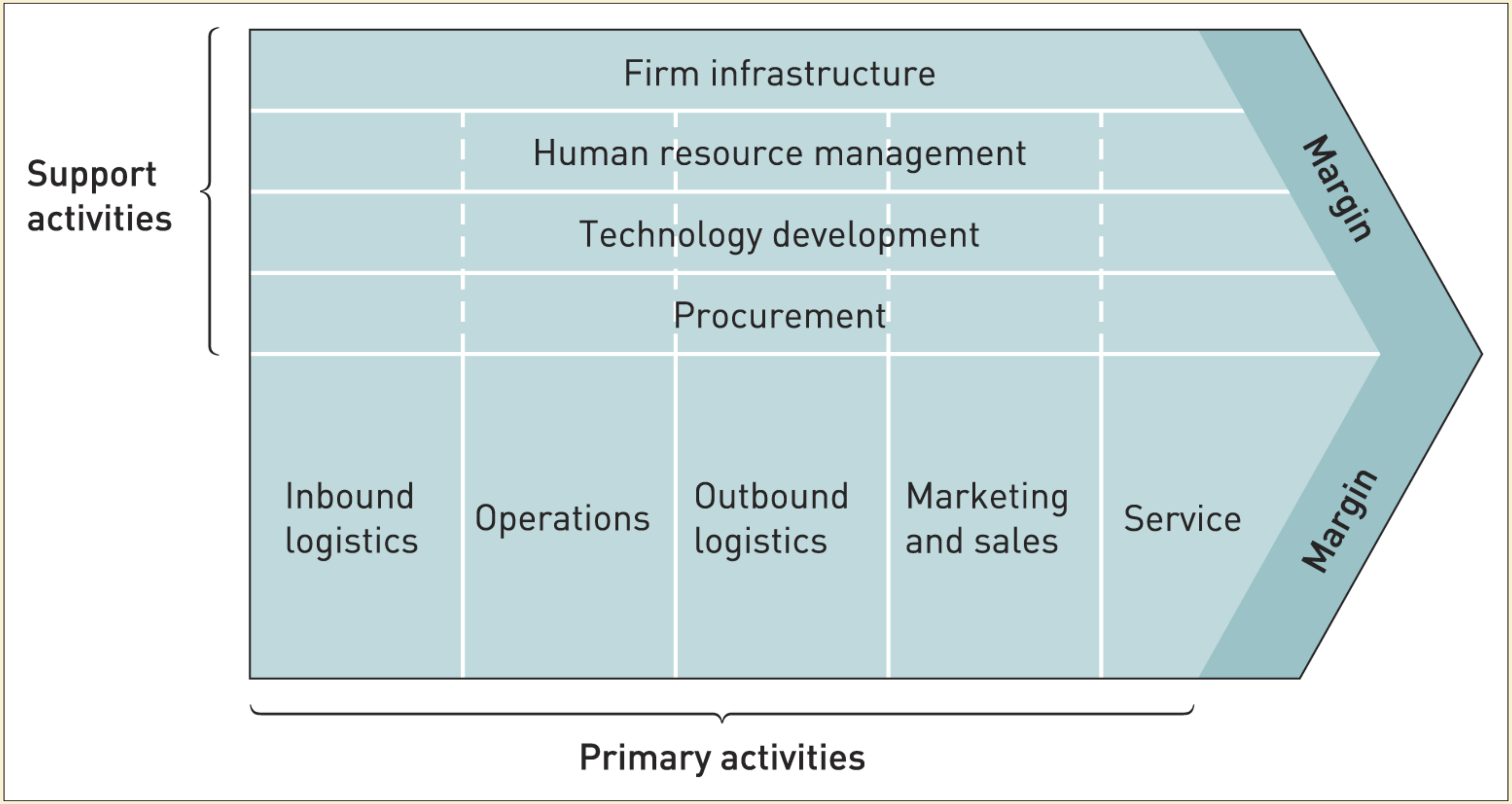
- **Industry/sector benchmarking** – comparing performance vs. other organisations in the same industry/sector against a set of performance indicators (strategic groups could also be considered)
- **Best-in-class benchmarking** – comparing an organisation's performance or capabilities vs. 'best-in-class' performance – wherever that is found even in a very different industry e.g. BA benchmarked its refuelling operations against Formula 1.

Two potential limitations:

- Surface comparisons limited to comparing outputs (instead of identifying the underlying capabilities)
- Ambition could be limited to simply achieving competitive parity

Diagnosing strategic capabilities: The value chain

- ***The value chain*** describes the categories of activities within an organisation which together create a product or service.
- The value chain consists of five primary activities (which are directly concerned with the creation or delivery of a product or service) and four support activities (which help to improve the effectiveness or efficiency of primary activities).
- Competitive advantage can be analysed in any of these activities.



Uses of the value chain

- ***A generic description of activities*** – understanding how the discrete activities (or clusters of linked activities) contribute to consumer benefit, e.g. perhaps a business is especially good in outbound logistics linked to its marketing and sales operation and supported by its technology development while it may not be so good in terms of its operations and inbound logistics
- ***Identifying activities*** where the organisation has particular strengths or weaknesses
- ***Analysing the competitive position*** of the organisation using the VRIO criteria – thus identifying sources of sustainable advantage

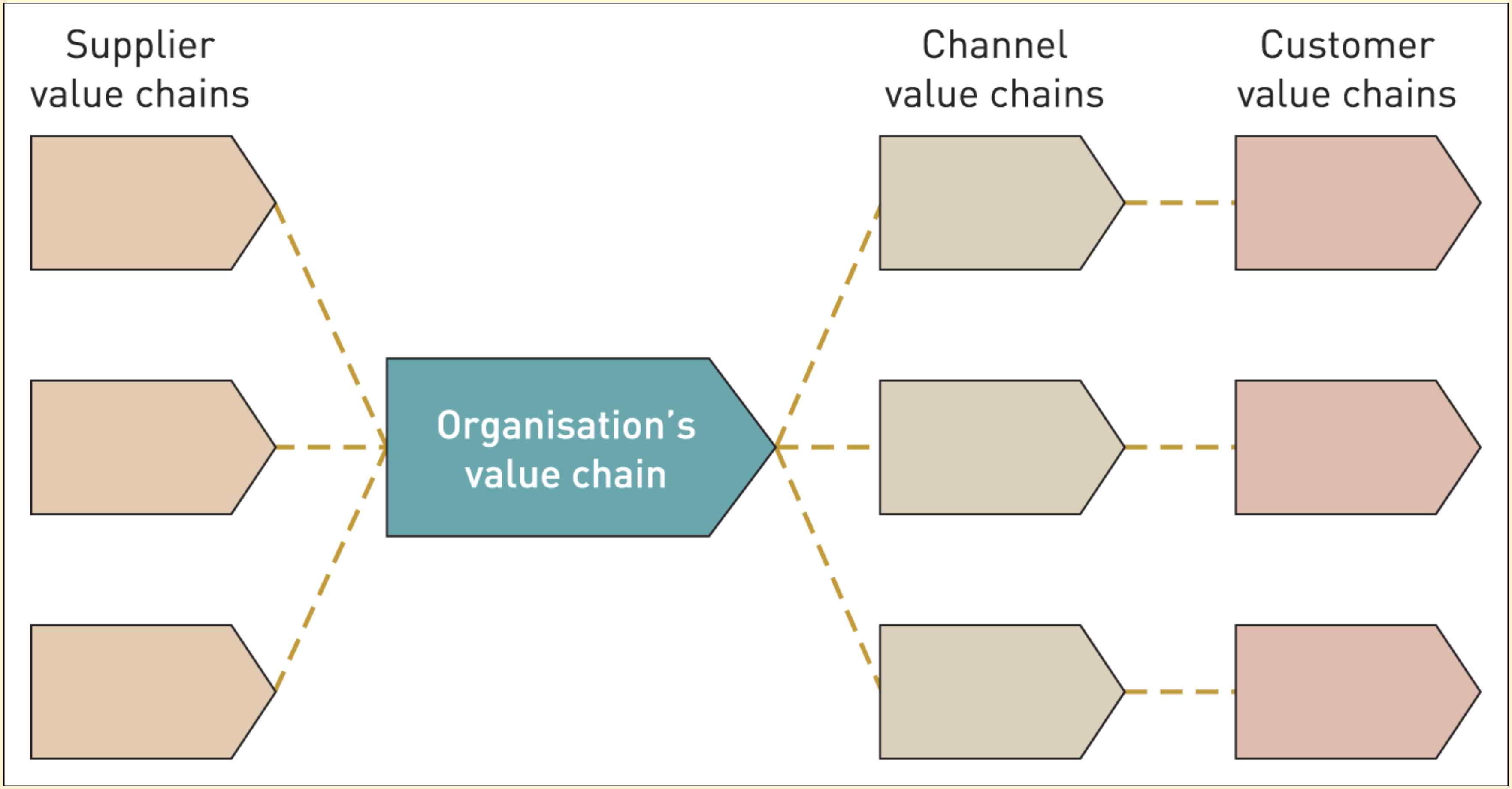
  V = value creating activities *R = rare value creating activities*

  I = Inimitable activities embedded and interlinked

  O = activities in other parts of the value chain facilitating value creation activities (e.g. management control systems in firm infrastructure supporting the primary activities)
- Looking for ways to ***enhance value or decrease cost*** in value activities (e.g. outsourcing)

Diagnosing strategic capabilities: The value system

- ***The value system*** comprises the set of inter-organisational links and relationships that are necessary to create a product or service.
- Competitive advantage can be derived from ***linkages*** within the value system.



Uses of the value system

- **Understanding cost/price structures** across the value system – analysing the best area of focus and the best business model

  As an example consider fish farming in Uganda:

  Fishermen: sell for $1.30 / Kg   Buying agents: sell for $1.70 / Kg

  Fillet and processing factory: sell for $5.40 / Kg

  Traders and air-freight forwarders: sell for $14.60 / Kg

  Supermarkets: sell for $24.60 / Kg

- **Identifying 'profit pools'** (i.e. The levels of profit in different parts of the system) – seeking ways to use existing capabilities in order to exploit these (e.g. computer manufacturers, like IBM, turning into consulting services)
- **The 'make or buy' decision** – which activities to do 'in-house' and which to outsource (e.g. which activities are central to competitive advantage, for which activities there is high internal competency)
- **Partnering** – deciding who to work with and the nature of these relationships (e.g. suppliers, alliance partners).

SWOT analysis

SWOT provides a general summary of the Strengths and Weaknesses explored in an analysis of strategic capabilities (Lecture 3), and the Opportunities and Threats explored in an analysis of the environment (Lecture 2).

INTERNAL ANALYSIS = *STRENGTHS / WEAKNESSES*

EXTERNAL ANALYSIS = *OPPORTUNITIES /THREATS*

- SWOT can be used to examine strengths, weaknesses, ***in relation to competitors***.
- Focus on strengths and weaknesses that differ in *relative* terms compared to competitors and leave out areas where the organization is at par with competitors.
- Focus on opportunities and threats that are directly ***relevant*** for the specific organization and industry and leave out general and broad factors.
- Finally, ***summarize the results*** and draw concrete ***conclusions***.

SWOT analysis example: Whirlpool

Strengths	Weaknesses
• Strong RnD (S1) • Whirlpool's culture (S2) • Quality (S3) • Marketing strategies (S4)	• Financial position (W1) • Global positioning (W2) • Manufacture facilities (W3)
Opportunities	**Threats**
• Economic integration of Europe (O1) • Internet / e-commerce (O2) • Economic development in Asia and L. America (O3) • Innovations (O4) • Increase of disposable income (O5) • Harmonization of standards (O6)	• Global competition (T1) • Demand saturated (T2) • Economies of scale (T3)

The TOWS matrix

		Internal factors	
		Strengths (S)	Weaknesses (W)
External factors	Opportunities (O)	**SO Strategic options** Generate options here that use strengths to take advantage of opportunities	**WO Strategic options** Generate options here that take advantage of opportunities by overcoming weaknesses
	Threats (T)	**ST Strategic options** Generate options here that use strengths to avoid threats	**WT Strategic options** Generate options here that minimise weaknesses and avoid threats

- ***The TOWS matrix*** is a useful tool towards focusing discussion on future choices and the extent to which the organization is capable of supporting the associated strategies.

TOWS matrix example: Whirlpool

Internal Factors / External Factors	*Strengths* *S1 R n D* *S2 Whirlpool's Culture* *S3 Quality* *S4 Marketing Strategies*	*Weaknesses* *W1 Financial Position* *W2 Global Positioning* *W3 Manufacture Facilities*
Opportunities *O1 Economic integration of Europe* *O2 Internet / e-commerce* *O3 Economic development in Asia and L. America* *O4 Innovations* *O5 Increase in disposable income* *O6 Harmonization of standards*	***SO Strategies*** *S1O3* Focus on Asian mrket and make products conforming to living patterns *S4O5* Increase marketing capabilities to the upscale market *S2O3* Get ready for the internet boom	***WO Strategies*** *W1W2O3* Cut costs and go for mergers in Asia *W2O4* Bring new products to market to get better position globally
Threats *T1 Global competition* *T2 Demand saturated* *T3 Economies of scale*	***ST Strategies*** *S2S3T2* Buy Maytag to increase market share in U.S *S1S4T1* Leverage use of RnD and marketing to compete on global fronts	***WT Strategies*** *W1T3* Shift facilities to India and China for cheap labor. *W1T2* Sell some of the facilities and units not profitable

Dangers in a SWOT analysis

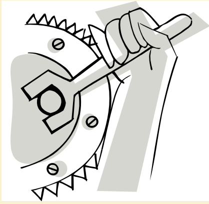
- Long lists with ***no attempt at prioritisation***.
- ***Over generalisation*** – sweeping statements often based on biased and unsupported opinions.
- SWOT is used as ***a substitute for analysis*** – it should result from detailed analysis using the frameworks in Lectures 2 and 3.
- SWOT is ***not used to guide strategy*** – it is seen as an end in itself.

Developing strategic capabilities

How can managers create, extend or upgrade an organization's strategic capabilities after having diagnosed them?

- ***Internal capability development***
  - ***Building and recombining capabilities*** – this requires creative entrepreneurial skills (e.g. a culture that promotes capability innovation)
  - ***Leveraging capabilities*** – identifying capabilities in one part of the organisation and transferring them to other parts (sharing best practice)
  - ***Stretching capabilities*** – building new products or services out of existing capabilities (related diversification).
- ***External capability development*** – adding capabilities through mergers, acquisitions or alliances
- ***Ceasing activities*** – non-core activities can be stopped, outsourced or reduced in cost
- ***Monitor outputs and benefits*** – to better understand sources of consumer benefit and enhance anything that contributes to this
- ***Awareness development*** – the bases of competitive advantage often lie in the day-to-day activities, hence, recognising what enhances strategy is key. Training, development and organisation learning are important.

Case study exercise: Domino's Pizza



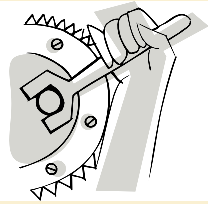
<u>You are given the following information regarding the company and its environment:</u>

- It is the largest worldwide pizza chain
- It serves high calorie, high fat foods
- Current trend towards healthier lifestyles
- There is high competition from other chains as well as independent pizza shops
- Current trend in many markets towards regional tastes
- Has strong brand image
- Has quick service
- Has high employee turnover; no career path for employees
- Has decreasing domestic sales
- Has increasing international sales
- New emerging markets where Domino Pizza has limited or no presence
- Has large menu selection
- Has efficient supply chain
- New online and mobile technology impacting ordering and delivery methods
- Increase in labor and raw material prices

<u>Questions:</u>

- Classify the above information into strengths, weaknesses, opportunities and threats.
- Draw a TOWS matrix and suggest possible future strategic choices for the company.

Assignment Part 3



- Using suitable frameworks (e.g. benchmarking, value chain, value system), diagnose the **strategic capabilities** of the selected organization and classify them using the VRIO criteria.
- Prepare a suitable **SWOT / TOWS** matrix summarizing the findings of the analysis of strategic capabilities and the analysis of the external environment (from Part 2 of the assignment).

(15% of total mark)