Chapter 3
The Internal Environment: Resources, Capabilities and Core Competence

What affects our business from the Inside?

External and Internal Analyses
By studying the external environment, firms identify what they might choose to do
Opportunities and threats

External and Internal Analyses
By studying the internal environment, firms identify what they can do
Unique resources, capabilities, and core competencies (sustainable competitive advantage)
Challenge of Internal Analysis

- How do we effectively manage current core competencies while simultaneously developing new ones?
- How do we assemble bundles of resources, capabilities and core competencies to create value for customers?
- How do we learn to change rapidly?

Three Conditions Affecting Managerial Decisions About Resources, Capabilities, and Core Competencies

- **Uncertainty** regarding characteristics of the general and the industry environments, competitors' actions, and customers' preferences
- **Complexity** regarding the interrelated causes shaping a firm's environments and perceptions of the environments
- **Intraorganizational Conflicts** among people making managerial decisions and those affected by them

Components of Internal Analysis

- **Discovering Core Competencies**
  - **Resources**
    - Tangible
    - Intangible
  - **Capabilities**
- **Competitive Advantage**
  - **Four Criteria of Sustainable Advantages**
    - Valuable
    - Rare
    - Costly to Imitate
    - Nonsubstitutable
- **Value Chain Analysis**
  - **Outsource**
Resources are what a firm has to work with—its assets—including its people and the value of its brand name. Resources represent inputs into a firm’s production process...such as capital equipment, skills of employees, brand names, finances and talented managers.

**Tangible Resources**
- Financial
- Physical
- Human resources
- Organizational

**Intangible Resources**
- Technological
- Innovation
- Reputation

Capabilities are what a firm does, and represent the firm's capacity or ability to integrate individual firm resources to achieve a desired objective.

Capabilities become important when they are combined in unique combinations which create core competencies which have strategic value and can lead to competitive advantage.

Core competencies are resources and capabilities that serve as a source of competitive advantage over rivals.

Core competencies distinguish a company competively and make it distinctive.

McKinsey and Co. recommends using three to four competencies when framing strategic actions.
Core Competence as a Strategic Capability

- **Resources**
  - Inputs to a firm’s production process

- **Core Competence**
  - A strategic capability

Does it satisfy the criteria of sustainable competitive advantage?

- Yes
- No

Capability
- An integration of a team of resources

- A nonstrategic team or resource

The Basic Value Chain

- Support Activities
- Firm Infrastructure
- Human Resource Management
- Technological Development
- Procurement

- Primary Activities
- Service
- Marketing & Sales
- Outbound Logistics
- Operations
- Inbound Logistics

Outsourcing

Outsourcing is the purchase of some or all of a value-creating activity from an external supplier.

Usually this is because the specialty supplier can provide these functions more efficiently.
Strategic Rationales for Outsourcing

- **Improve Business Focus**
  - lets company focus on broader business issues by having outside experts handle various operational details

- **Provide Access to World-Class Capabilities**
  - the specialized resources of outsourcing providers makes world-class capabilities available to firms in a wide range of applications

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Strategic Rationales for Outsourcing

- **Accelerate Business Re-Engineering Benefits**
  - achieves re-engineering benefits more quickly by having outsiders—who have already achieved world-class standards—take over process

- **Share Risks**
  - reduces investment requirements and makes firm more flexible, dynamic and better able to adapt to changing opportunities

- **Free Resources for Other Purposes**
  - permits firm to redirect efforts from non-core activities toward those that serve customers more effectively

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Outsourcing Issues

- **Greatest Value**
  - outsource only to firms possessing a core competence in terms of performing the primary or support activity being outsourced

- **Evaluating Resources and Capabilities**
  - don’t outsource activities in which the firm itself can create and capture value

- **Environmental Threats and Ongoing Tasks**
  - do not outsource primary and support activities that are used to neutralize environmental threats or complete necessary ongoing organizational tasks
Outsourcing Issues

- **Non-strategic Team of Resources**
  - do not outsource capabilities that are critical to their success, even though the capabilities are not actual sources of competitive advantage

- **Firm’s Knowledge Base**
  - do not outsource activities that stimulate the development of new capabilities and competencies

Core Competencies: Cautions and Reminders

- Never take for granted that core competencies will continue to provide a source of competitive advantage
- All core competencies have the potential to become *core rigidities*
- Core rigidities are former core competencies that now generate inertia and stifle innovation