

Chapter 4: Internal Analysis: Resources, Capabilities, and Core Competencies

Joe Mahoney

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BA449






Chapter Case 4:

Dr. Dre's Core Competency: Coolness Factor

Chapter Case 4: Beats by Dr. Dre

- Dr. Dre (Andrew Young)
 - First hip-hop billionaire
 - Successful music producer, rapper, and entrepreneur
 - Strong work ethic, expects perfection
 - One of the best-connected businesspeople in music
 - Founded Beats Electronics: premium headphones
- Apple acquired Beats Electronics for \$3 billion
 - Largest acquisition in Apple's history
 - Hoping that some of Beats' coolness will spill over to its brand



Chapter Case 4: Beats by Dr. Dre

- **Beats' Coolness Factor**
 - Celebrity endorsements
 - Music celebrities wore them in their music videos.
 - Famous athletes wear them in public.
 - Custom Beats created for stars
- **Disruption in Content Delivery**
 - Changing from downloads to streaming
 - Apple is lagging behind Pandora
 - iTunes radio was created in 2013, has been falling flat



Chapter Case 4: Beats by Dr. Dre

- Did Apple purchase Beats for its talent?
 - Talents of Beats' co-founders (Jimmy Lovine & Dr. Dre)
 - They have creative talent.
 - They have a successful track record.
 - They have deep and far-reaching networks.
 - Apple has lacked visionary leadership since Jobs' death.
 - Both Levine and Dr. Dre are taking leadership roles at Apple.
 - Bringing in flashy celebrities might have been unthinkable for Jobs.



Chapter Case 4: Beats by Dr. Dre

- If Beats Electronics' core competencies are indeed intangibles, such as marketing savvy, do you think these (intangible) core competencies will remain as valuable under Apple's ownership? Why or why not?



What Are Core Competencies?

- Unique strengths
- Embedded deep within a firm
- Enables a firm to differentiate its products and services from those of its rivals
- Results in:
 - Creating higher value for the customer or
 - Offering products and services at lower cost



Competitive Advantage based on Core Competencies, Resources, Capabilities

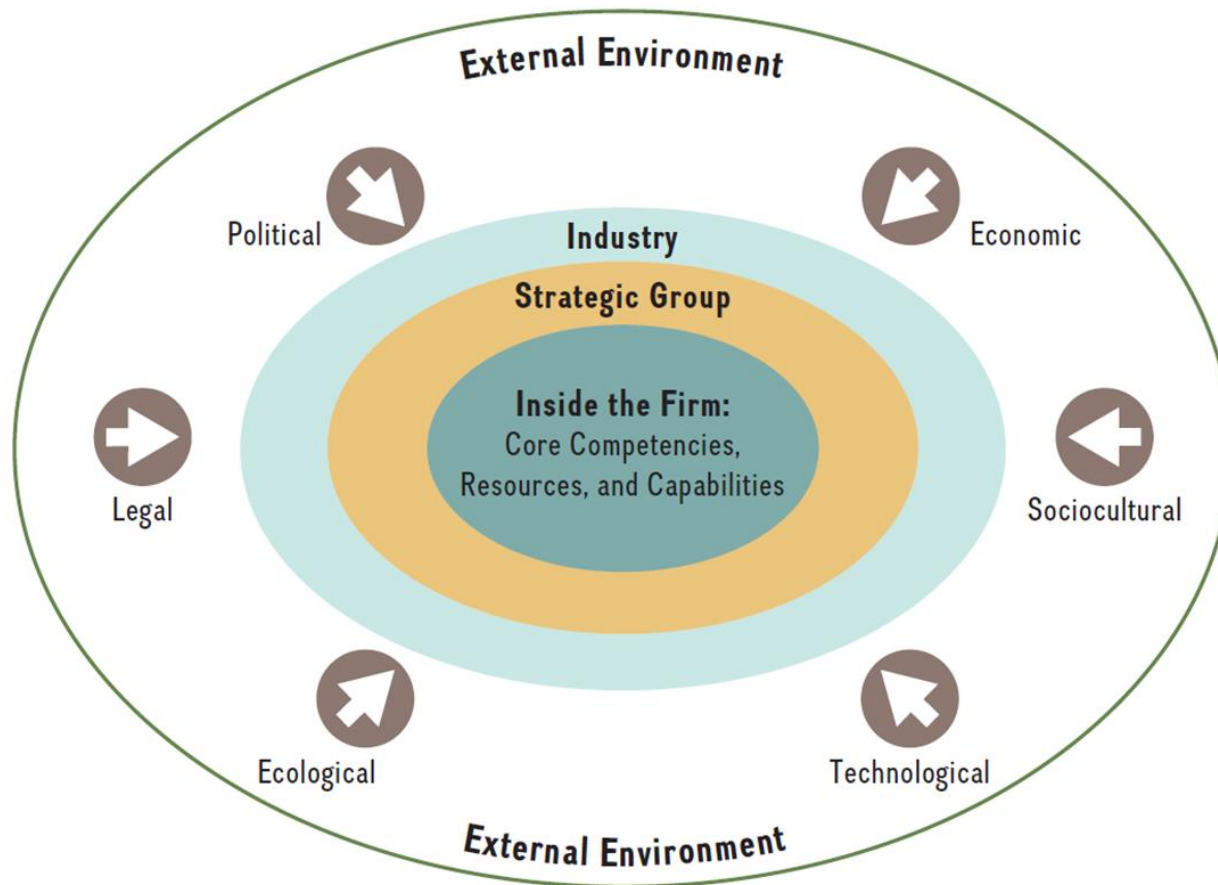
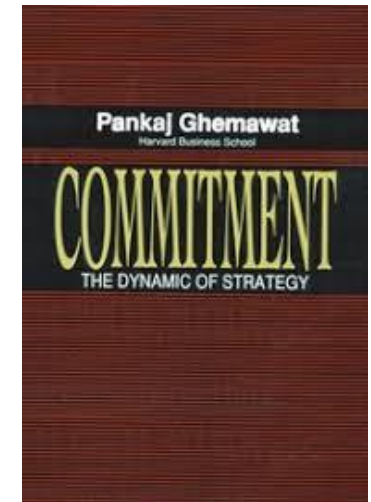
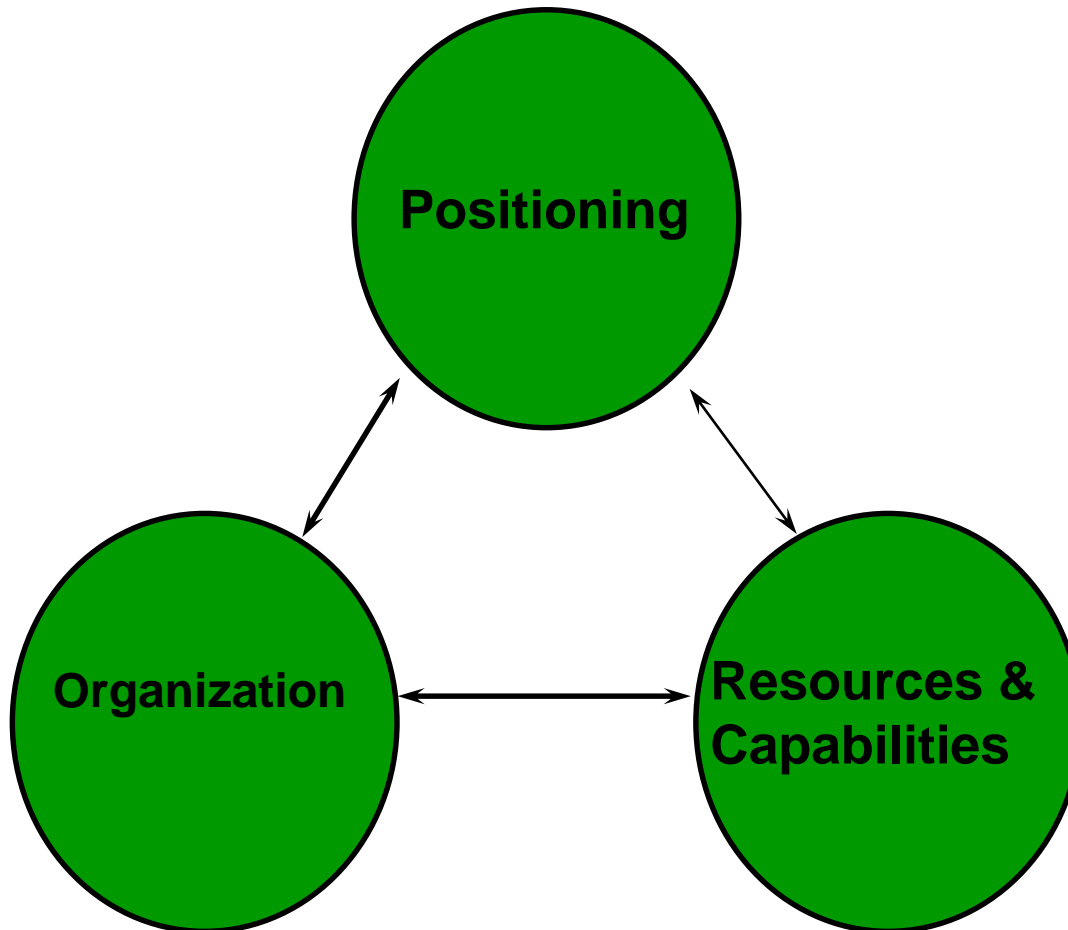


Exhibit 4.1



The Role of Strategy in Business is to Generate and Sustain Value via the Linkages Between Positioning, Organization, and Resources & Capabilities



Positioning

- **Scope of the Firm:**

- **Geographic scope**
- **Product-market scope:**
Choice of businesses
(corporate portfolio analysis)
- **Product market positioning**
within a business
- **Vertical integration (value chain)**
decisions



Organization

- **Structure**

- Formal definition of authority
- Conflict resolution
 - ❖ (E.g., mediation, arbitration)

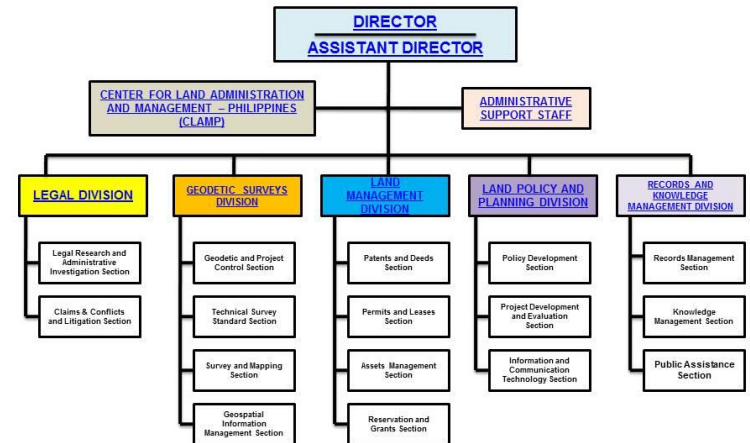
- **Systems**

- Rules, routines, evaluation and rewards

- **Processes**

- Informal communication, networks, and recruitment

ORGANIZATIONAL STRUCTURE



Resources and Capabilities

- **Tangible resources**

- e.g., physical capital



- **Organizational capabilities**

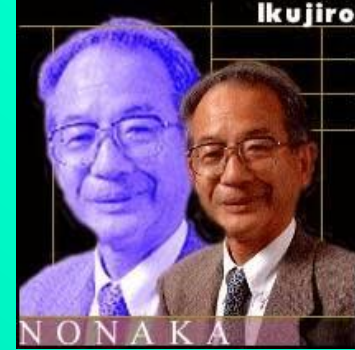
- e.g., routines and standard operating procedures

- **Intangible resources**

- e.g., trademarks, “know-how”



Knowledge Types and Knowledge Conversion



Levels of knowledge

Individual

Organization

Explicit

Types
of
Knowledge

Tacit

Information
Facts
Scientific kn.

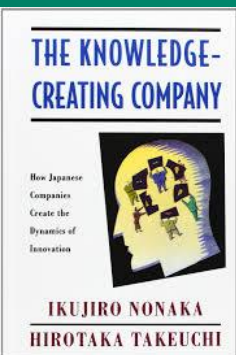
Databases
Systems & procedures
Intellectual property

'INDUSTRIAL'
ENTERPRISES

CRAFT
ENTERPRISES

Skills

Organizational
capabilities



Links to Competitive Advantage and Superior Firm Performance

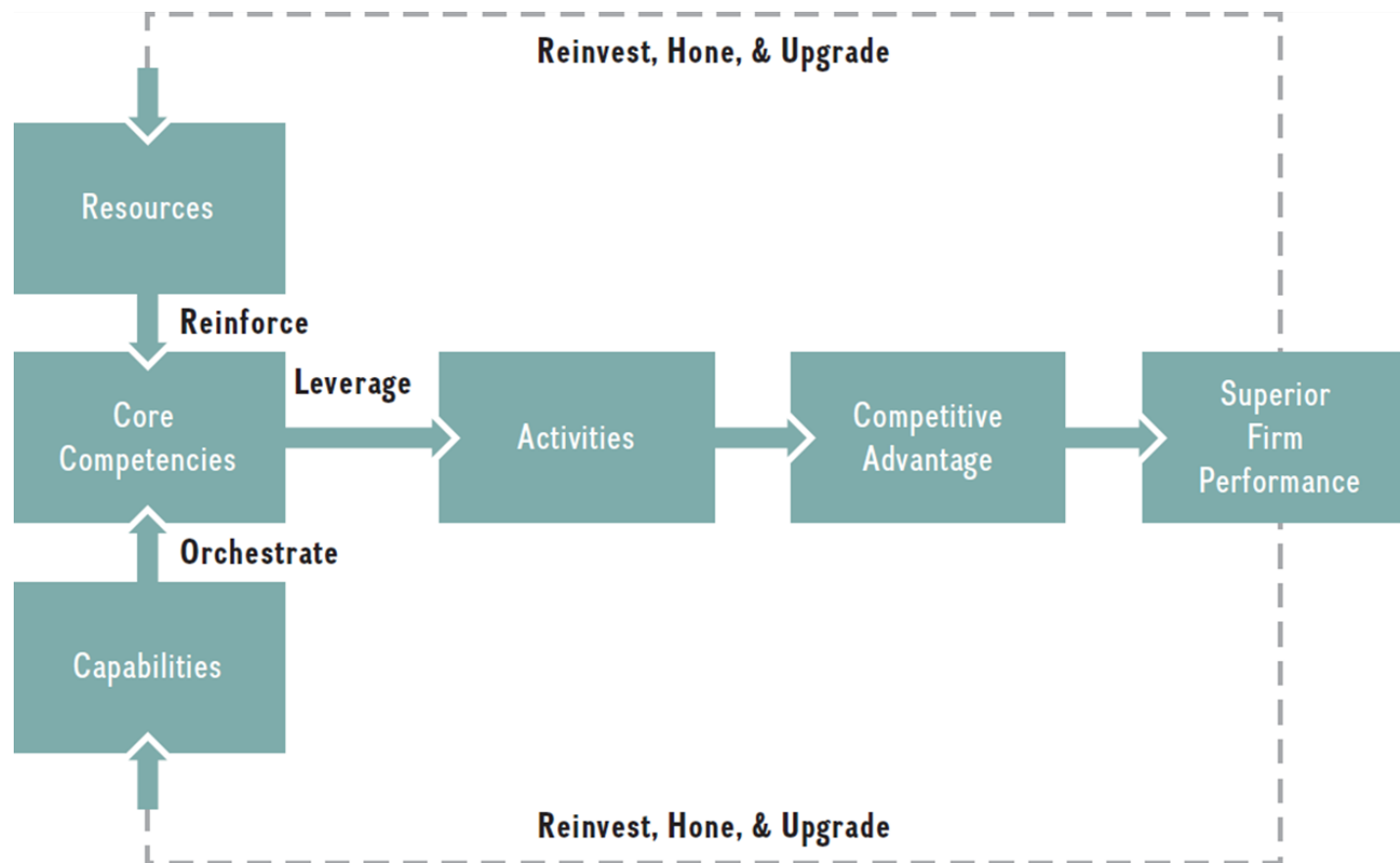


Exhibit 4.3





The Resource-Based View (RBV)

Canon: Products and Core Technical Capabilities

Precision Mechanics



Fine Optics

35mm SLR camera
Compact fashion camera
EOS autofocus camera
Digital camera
Video still camera

Plain-paper copier
Color copier
Color laser copier
Laser copier

Basic fax
Laser fax

Mask aligners
Excimer laser aligners
Stepper aligners

Inkjet printer
Laser printer
Color video printer

Calculator
Notebook computer

Micro-Electronics



Canon

Tangible and Intangible Resources

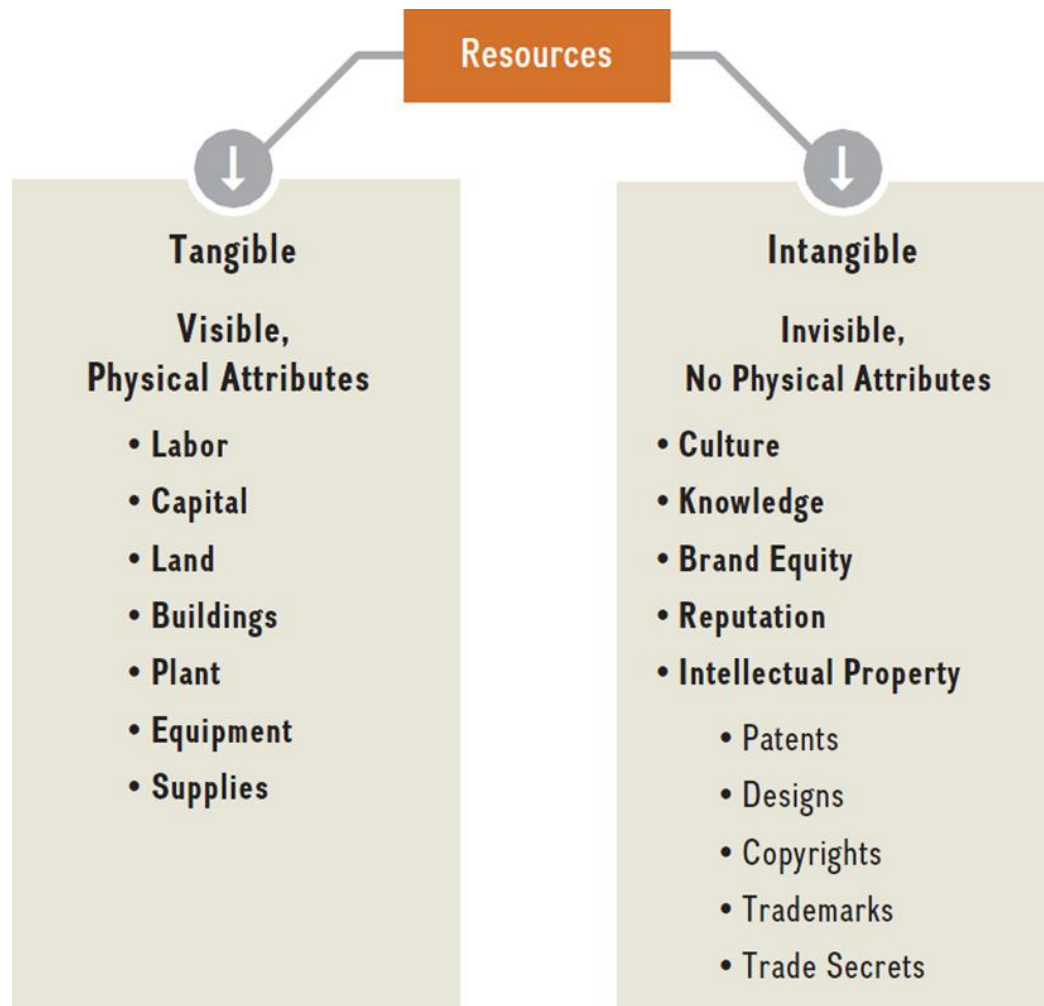


Exhibit 4.4



Appraising Resources

RESOURCE		CHARACTERISTICS	INDICATORS
Tangible Resources	Financial	Borrowing capacity Internal funds/ generation	Debt/ Equity ratio Credit rating Net cash flow
	Physical	Plant and equipment: size, location, technology flexibility. Land and buildings. Raw materials.	Market value of fixed assets. Scale of plants Alternatives for fixed assets
Intangible Resources	Technology	Patents, copyrights, know how R&D facilities. Technical and scientific employees	No. of patents owned. Royalty income R&D expenditure. R&D staff
	Reputation	Brands. Customer loyalty. Company reputation (with suppliers, customers, government)	Brand equity. Product price premium. Recognition.
Human Resources		Training, experience, adaptability, commitment and loyalty of customers	Employee qualifications, pay rates, turnover.

The Resource-based View

- **Google Example:**

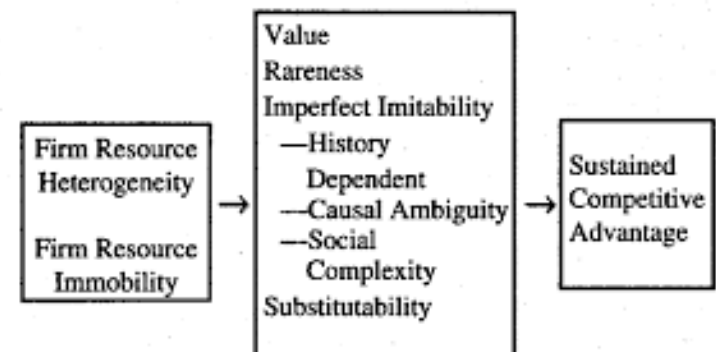
- Tangible resources valued at \$15 billion
- Intangible brand valued at over \$160 billion
- Googleplex has both tangible and intangible aspects



- Competitive Advantage More Likely.....
 - From *intangible* resources (e.g., networks)

Two Critical Resource Dimensions of the RBV

- **Firm Resource Heterogeneity**
 - A firm is bundle of resources and capabilities that differ across firms
- **Firm Resource Immobility**
 - A firm has resources that tend to be “sticky” and that do not move easily from firm to firm



The VRIO Decision Tree

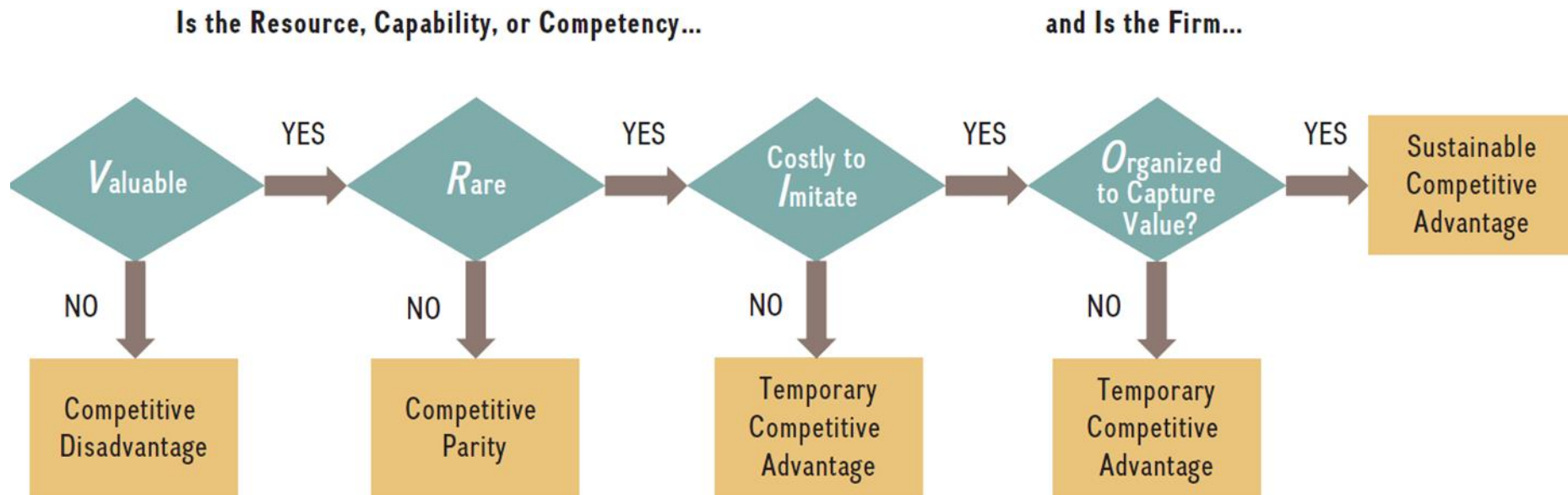


Exhibit 4.5



A Resource is Valuable If...

- It enables the firm to exploit an opportunity.
- It enables the firm to offset a threat.
- It enables a firm to increase its economic value creation ($V - C$).
 - There is demand for the resource.
- Example: **Beats Electronics**:
 - Design and marketing of premium headphones
 - Production = ~\$15
 - Retail = \$150 - \$450
 - Coolness factor translates to some cool profit!



A Resource is Rare If...

- Only one or a few firms possess it
- Example: **Beats Electronics:**
 - Product placement
 - Vast celebrity endorsement



A Resource Is Costly to Imitate If...

- Firms that do not possess the resource are unable to develop or buy the resource at a reasonable price.
- Example: **Beats Electronics**:
 - Dr. Dre relies on ***entrepreneurial judgment*** in making decisions rather than market research.
 - The ***social capital*** of Dr. Dre and Jimmy Lovine might be impossible to replicate.

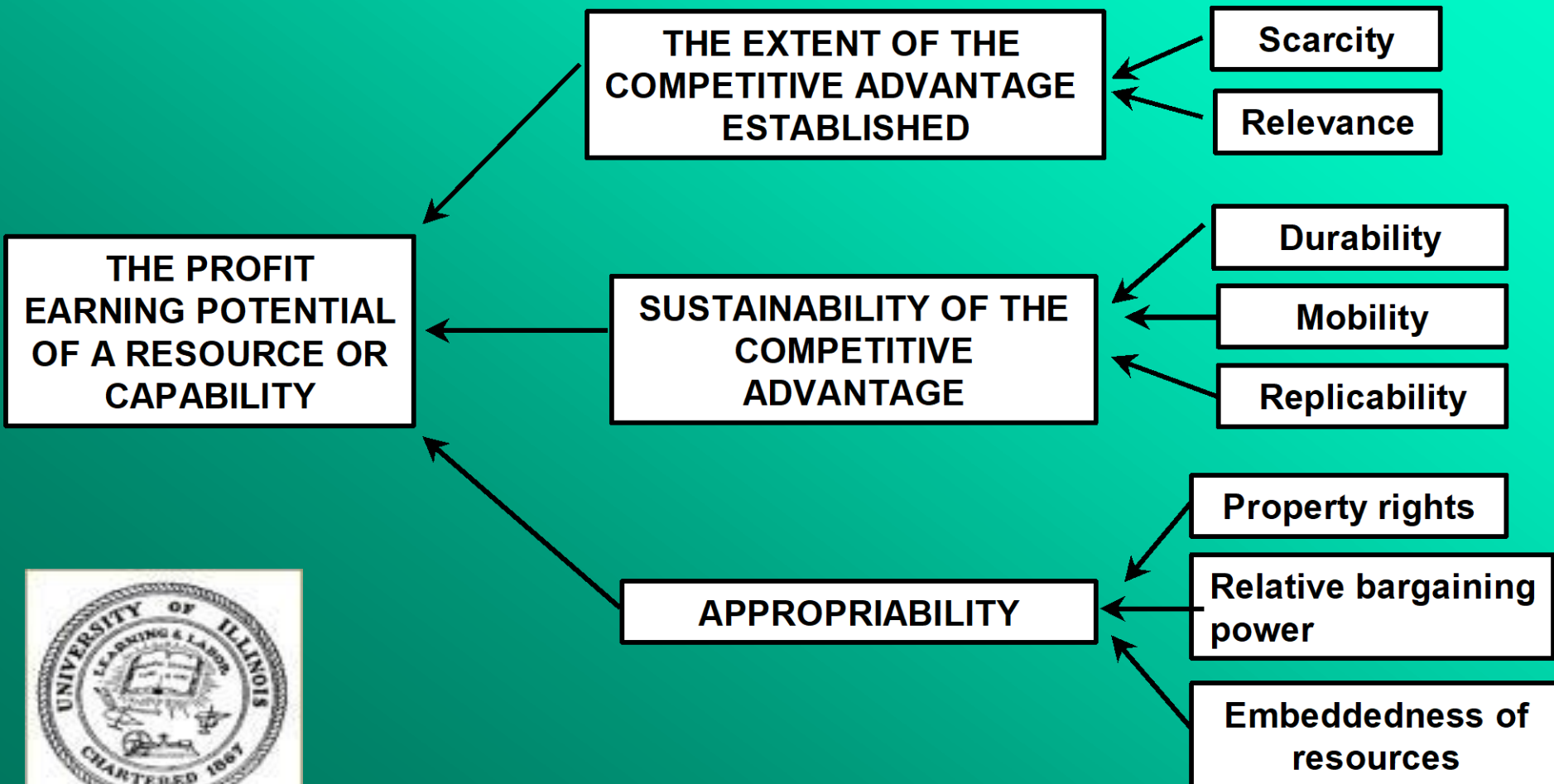


A Resource Is Organized to Capture Value If...

- It has an effective organizational structure.
- It has coordinating systems.
- Example: **Xerox Palo Alto Research Center (PARC):**
 - Developed the first Word-processing application Graphical User Interface (GUI), Ethernet, Mouse, Personal Computer
 - These innovations did not fit within the Xerox focus.
 - Management was busy pursuing innovations in the photocopier business --- *not organized to capture the gains!*

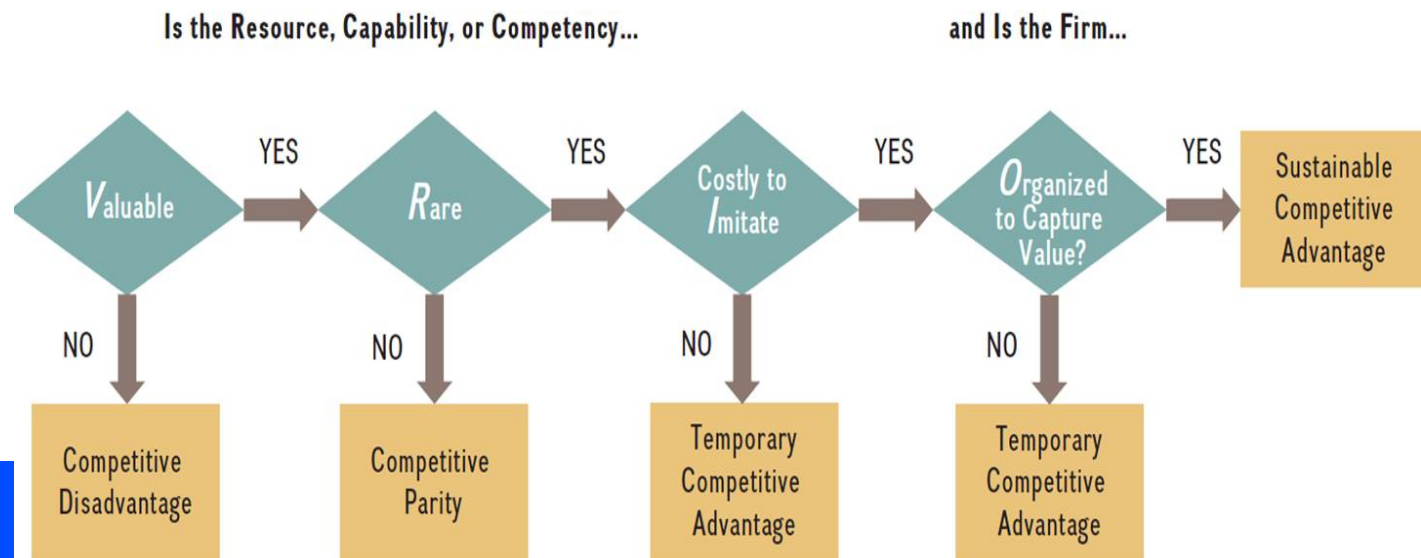


The Rent-Earning Potential of Resources and Capabilities



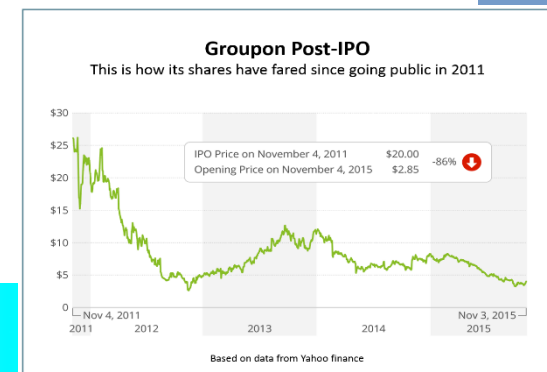
The Rise and Fall of Groupon (A VRIO VIEW)

- Based on the resource-based view and its framework of VRIO(N) --- Valuable, Rare, Inimitable, Organized to capture value, and Non-substitutable --- **explain the rise and fall of Groupon.**



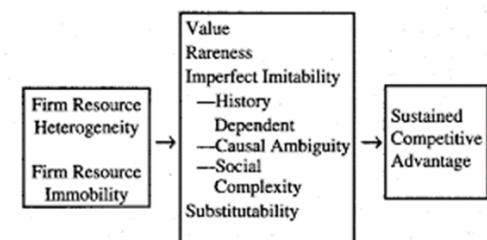
The Rise and Fall of Groupon (A VRIO VIEW)

- A daily-deal website, offering group coupons
- Grew quickly
 - 260 million subscribers, 500,000 merchants
 - \$6 billion buyout offer (Google 2011), was declined
 - Share price fell 90%
- It was valuable, and rare, but not costly to imitate.
 - More specialized local startups began

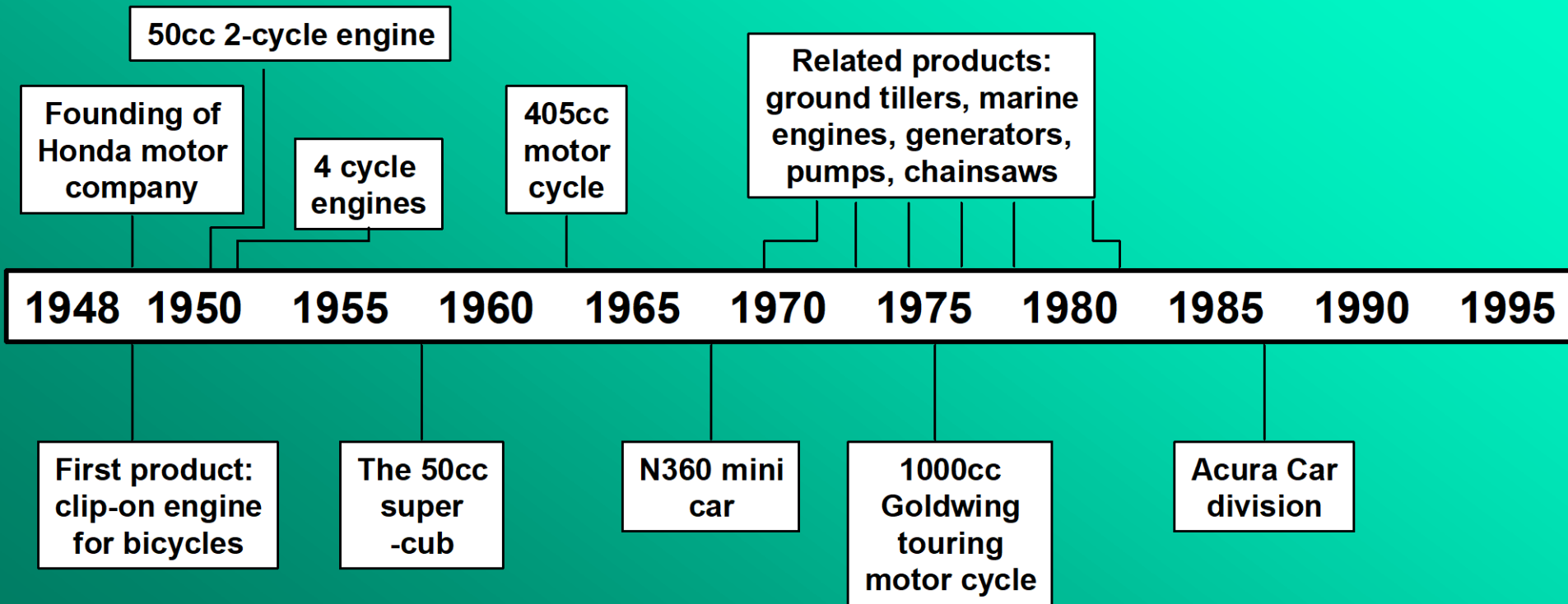


Isolating Mechanisms

- Barriers to imitation: protect resources and capabilities that underpin a firm's competitive advantage.
- Reasons for **imperfect imitability**:
 - **Path (history) dependent** (e.g., historical lock-in to older technology or historical development of technology; e.g., Honda's development of gas engines took decades and was leveraged across multiple products)
 - **Causal ambiguity** (i.e., cause and effect unclear)
 - **Social complexity** (e.g., social and business systems interact)
 - **Intellectual property (IP) protection** (e.g., patents)



The Evolution of Honda Motor Company





The Dynamic Capabilities Perspective

Dynamic Capabilities

- A firm's ability to:
 - Create, deploy, modify, reconfigure, upgrade, and leverage its resources over time (e.g., **Apple's** dynamic capabilities enabled it to redefine the markets for mobile devices and computing; in particular in music, smartphones, and media content).
- Helps prevent a **core rigidity**
 - A former core competency that turned into a liability as the environment changed.



IBM's Dynamic Capabilities

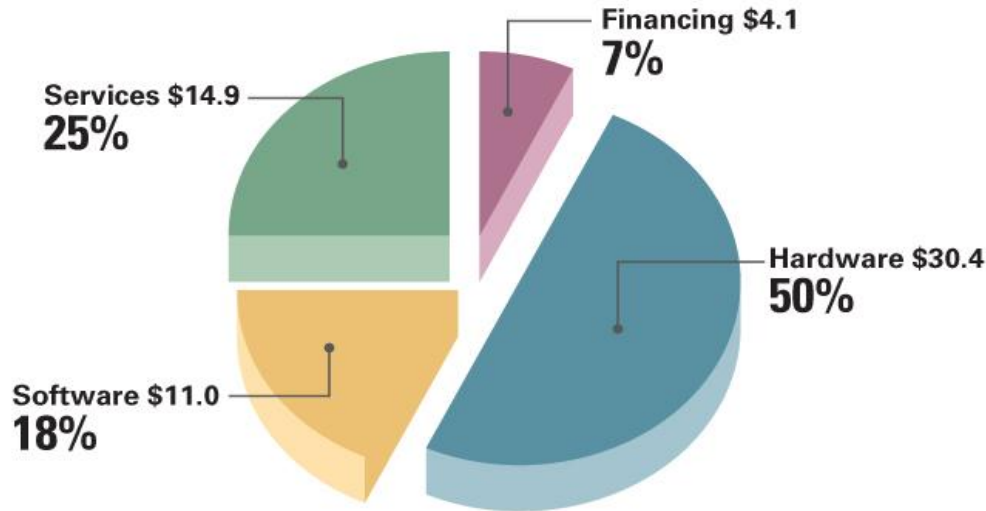


- From mainframes to services transformation
 - In 1992, fewer than 8,000 people in global services
 - In 2010, nearly 150,000 employees there
- IBM started the PC revolution...then became a misfit in the industry
- Lou Gerstner joined as CEO of a nearly bankrupt IBM
- Moved IBM downstream toward services and thus higher value added
- Transformation of core competency:
- Today, IBM is a nimble IT-services firm under CEO, [Virginia Rometty](#)
- IBM is a solutions company
 - Solves data-based problems for clients
 - The data/problems change over time



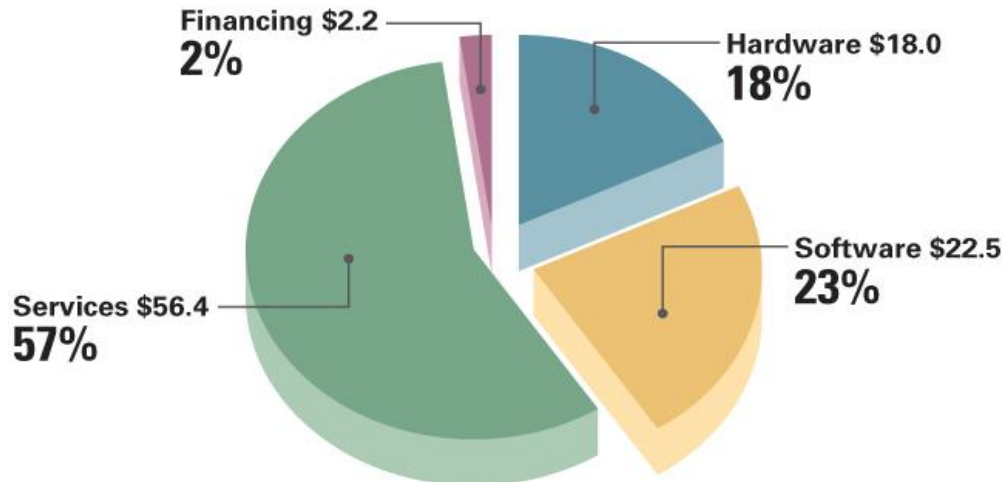
IBM Product Scope 1993 and 2010

IBM 1993 Product Scope (total revenues \$60bn)



In 1993, hardware accounted for 50% of IBM revenues

IBM 2010 Product Scope (total revenues \$99bn)



In 2010, software & services accounted for 80% of IBM revenues, hardware was down to 18%

Dynamic Capabilities at IBM

- **Current disruptions:**
 - **Cloud computing**
 - **Systems of engagement**
 - **Big data and analytics**



Dynamic Capabilities at IBM

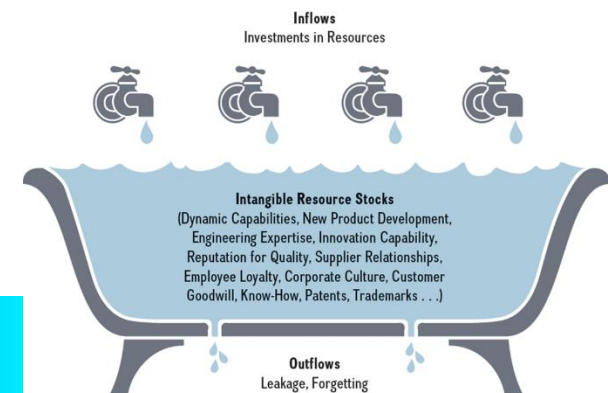
- Currently IBM (and its clients) are facing three (technological) disruptions at once:
 - (1) cloud computing;
 - (2) systems of engagement
(e.g., partnering with Apple); and
 - (3) big data and analytics.

Evaluate IBM's [awareness](#), [motivation](#), and [capabilities](#) (AMC) to master their three-pronged technology transformation.



Resource Stocks and Flows

- **Resource stocks**
 - The firm's current level of intangible resources
- **Resource flows**
 - The firm's level of investments to maintain or build a resource
 - Note: The resource stock (e.g., historical advertising intensity or R&D intensity) impacts the effectiveness of the current “flow”(of advertising and R&D intensity)



The Bathtub Metaphor

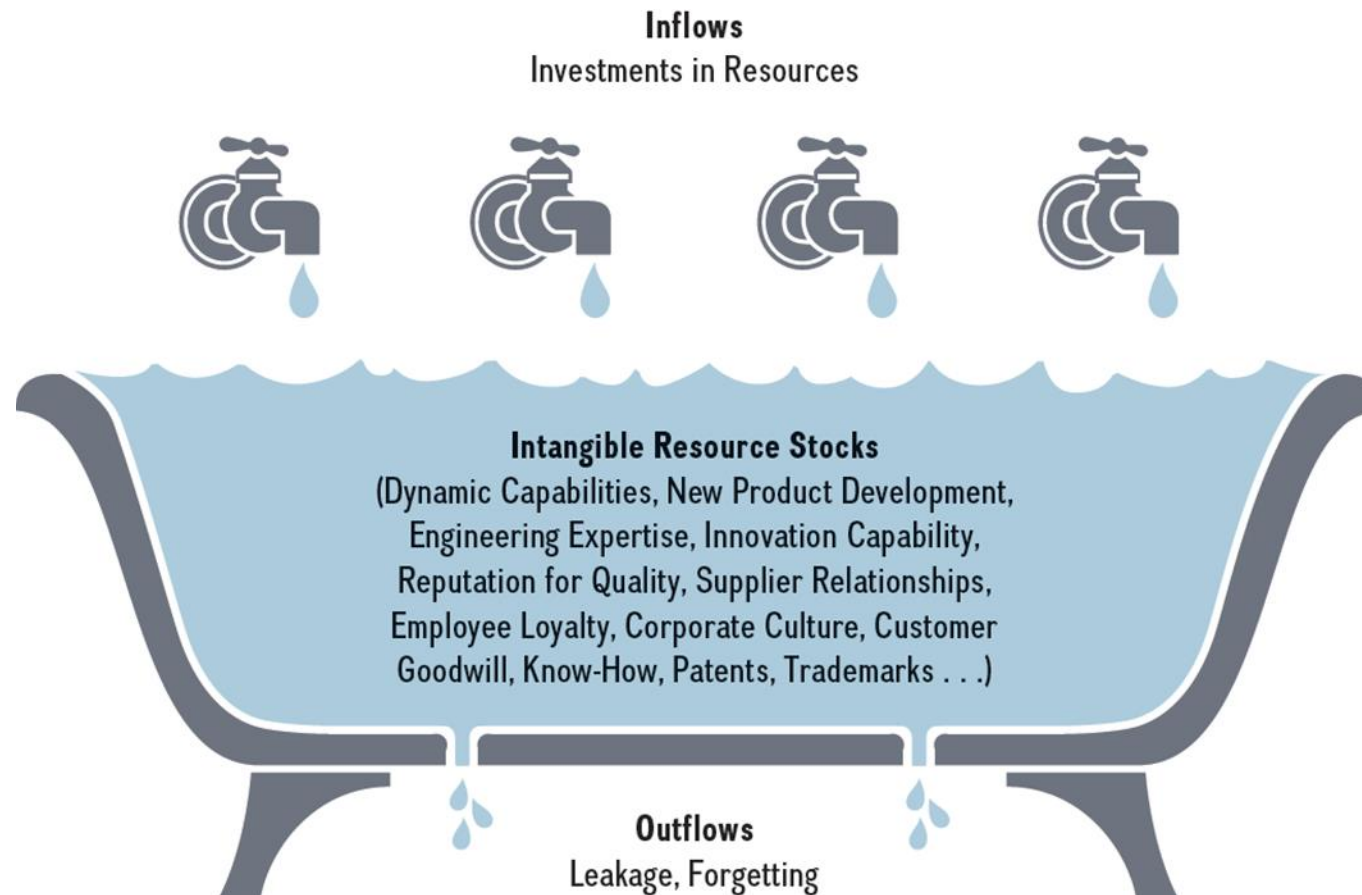
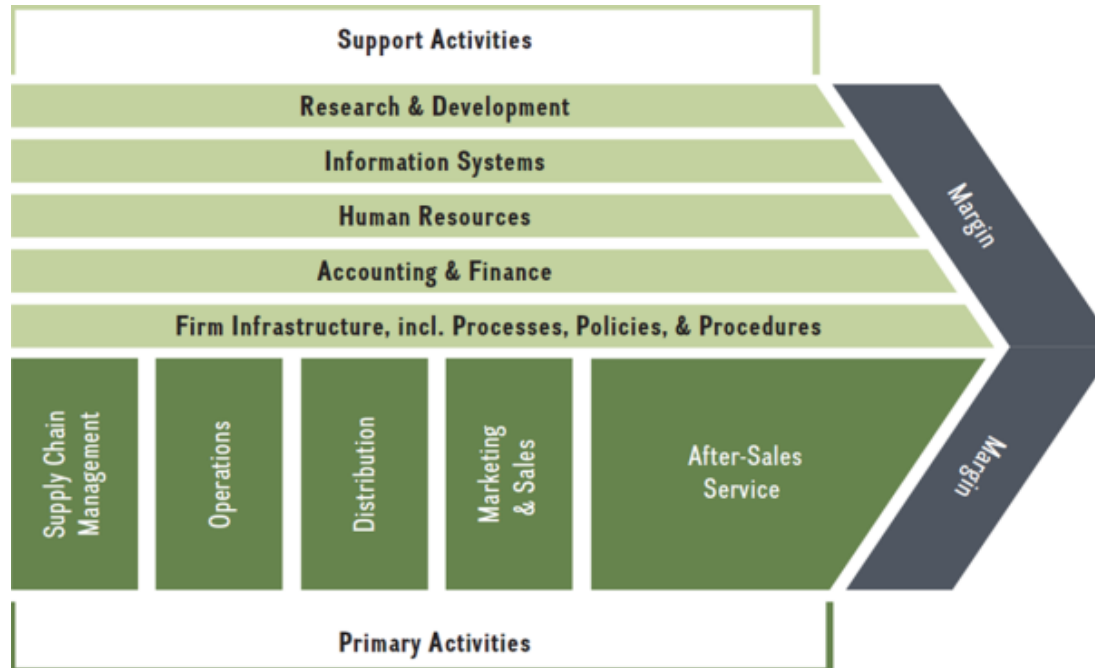


Exhibit 4.7

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.





Value Chain Analysis

The Value Chain

- Primary Activities

- Add value directly in transforming inputs into outputs

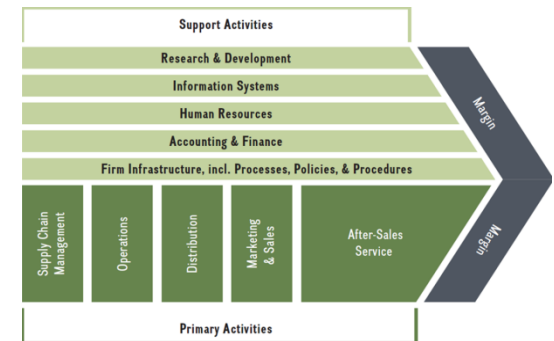
- ❖ Raw materials through production to customers

- Support Activities

- Indirectly add value

- ❖ Provide support to the primary activities

- ❖ Information systems, human resources, accounting, etc.



- Managers can see how competitive advantage flows from a system of activities (using activity-based accounting).

The Value Chain

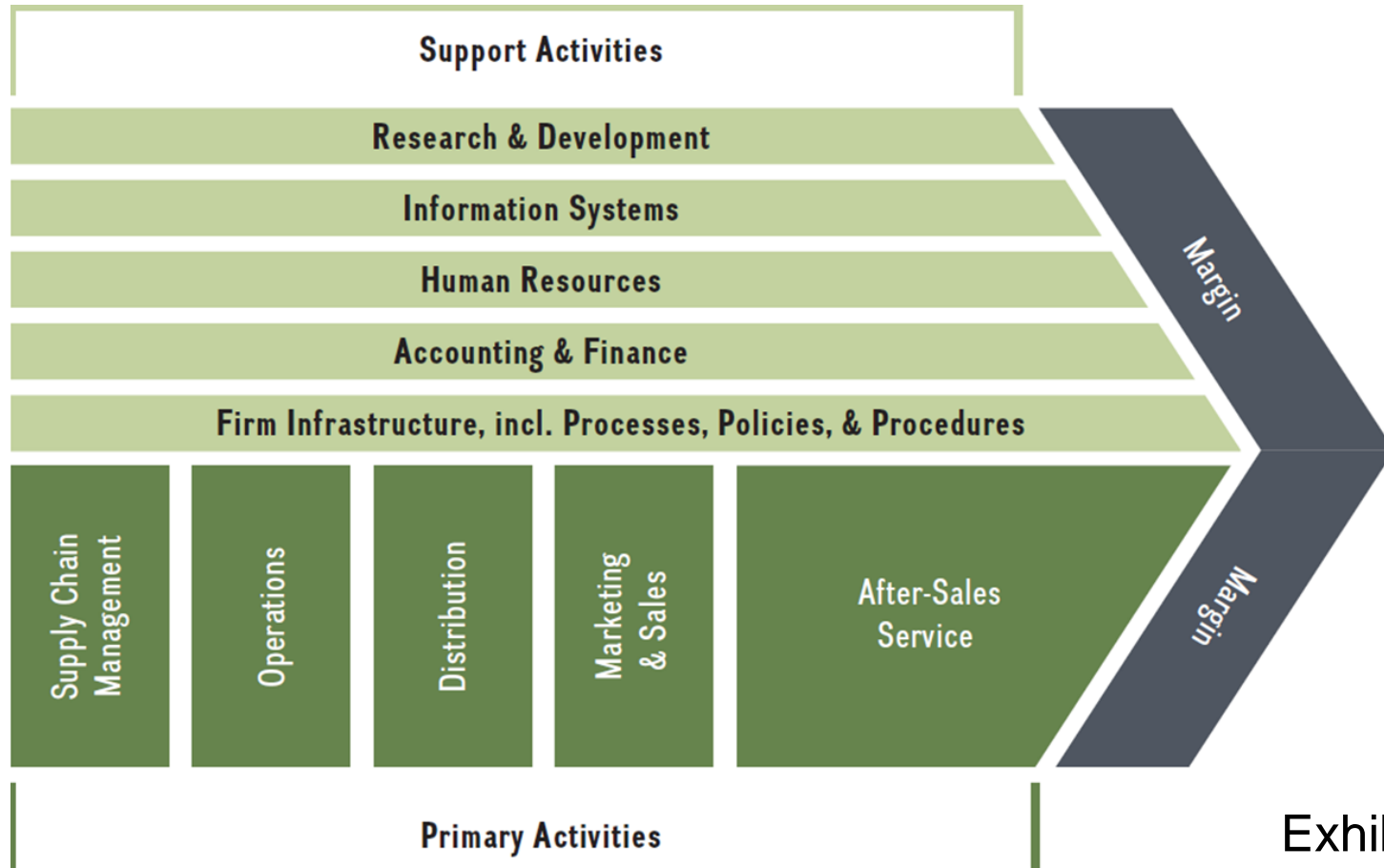
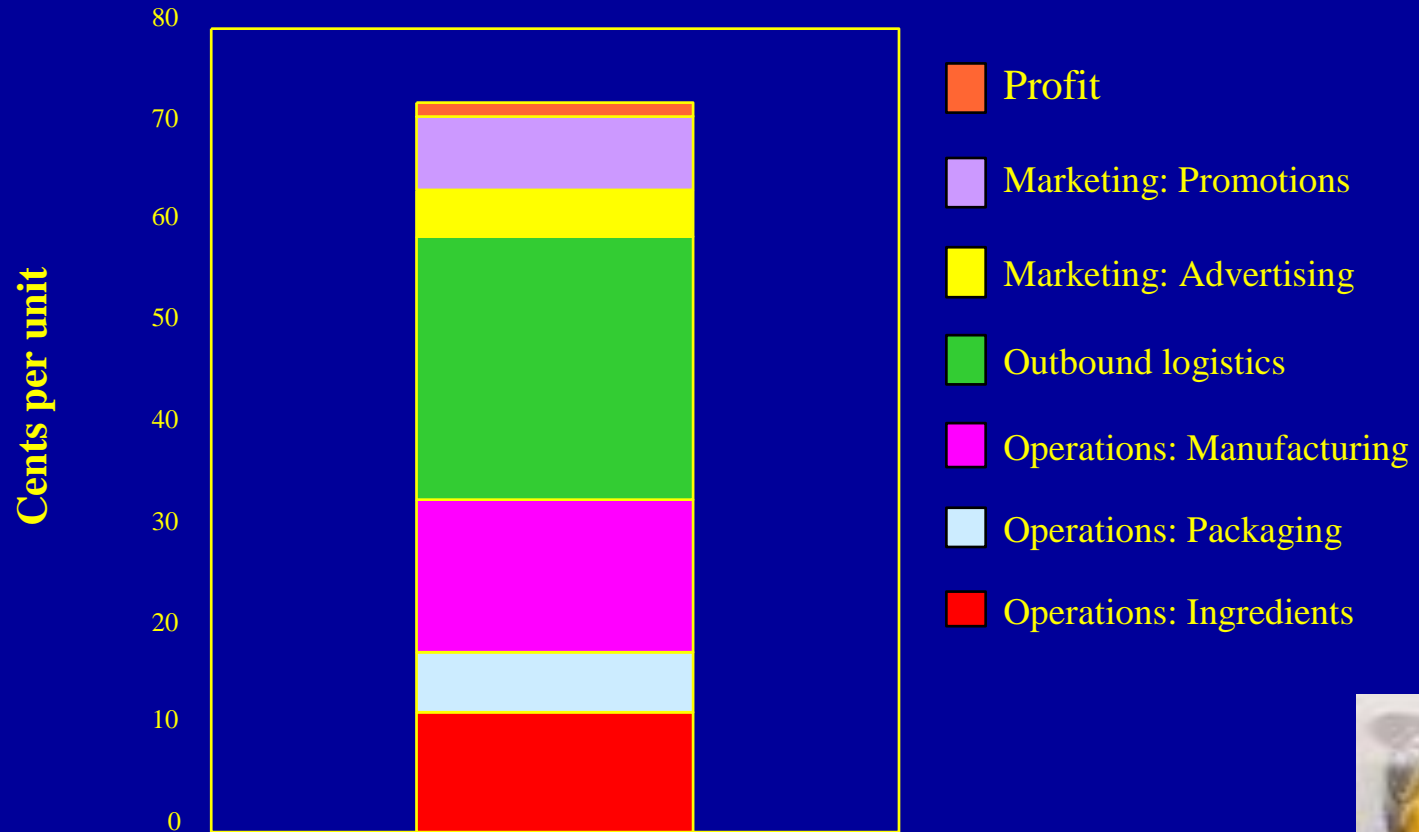


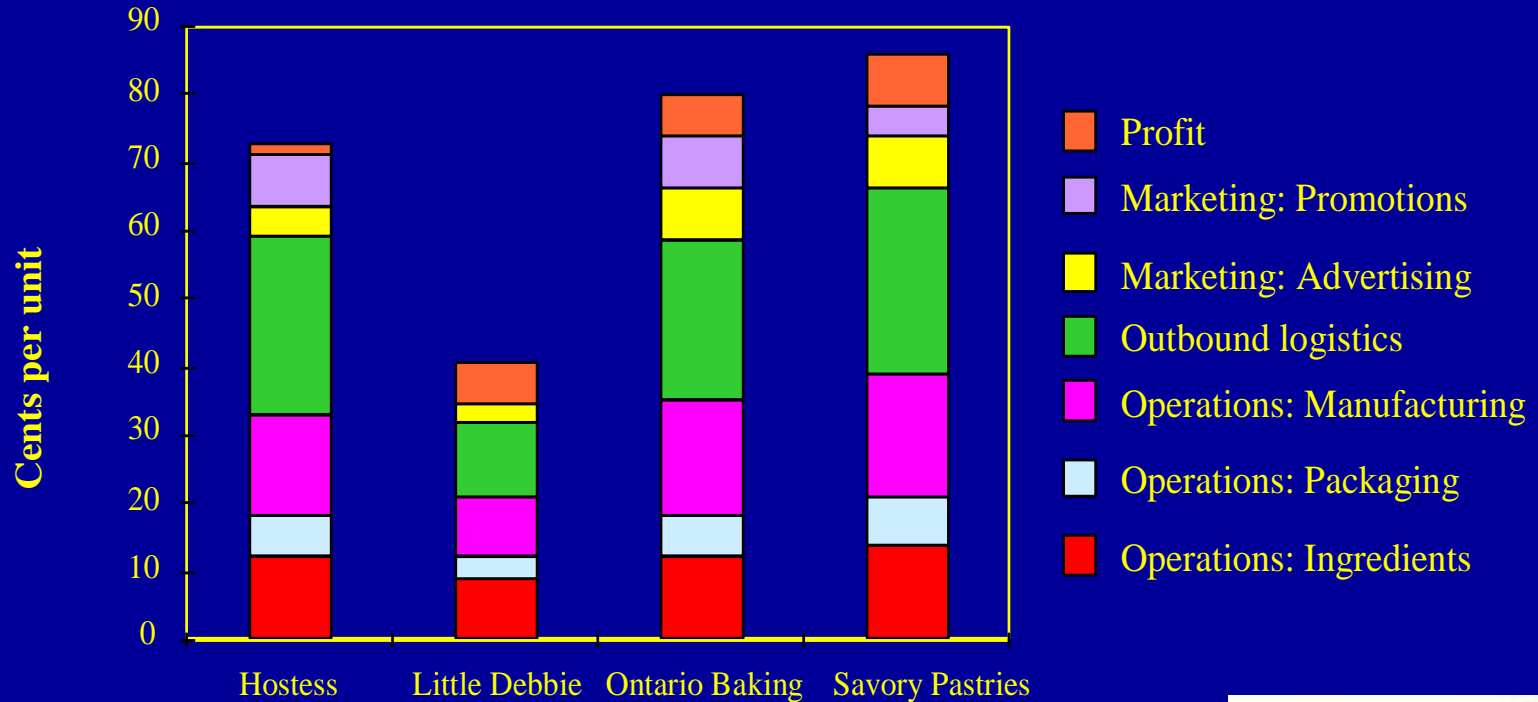
Exhibit 4.8



Hostess's Cost Components



Relative Cost Analysis



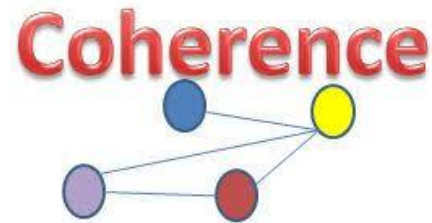
Value Chain Analysis

- **Outsourcing** activities can have the *unintended consequence* of damaging the firm's potential to evaluate continuously its key assumptions, learn, and create new capabilities and core competencies. Thus, managers should verify that the firm does not outsource activities that stimulate the development of new capabilities and competencies.



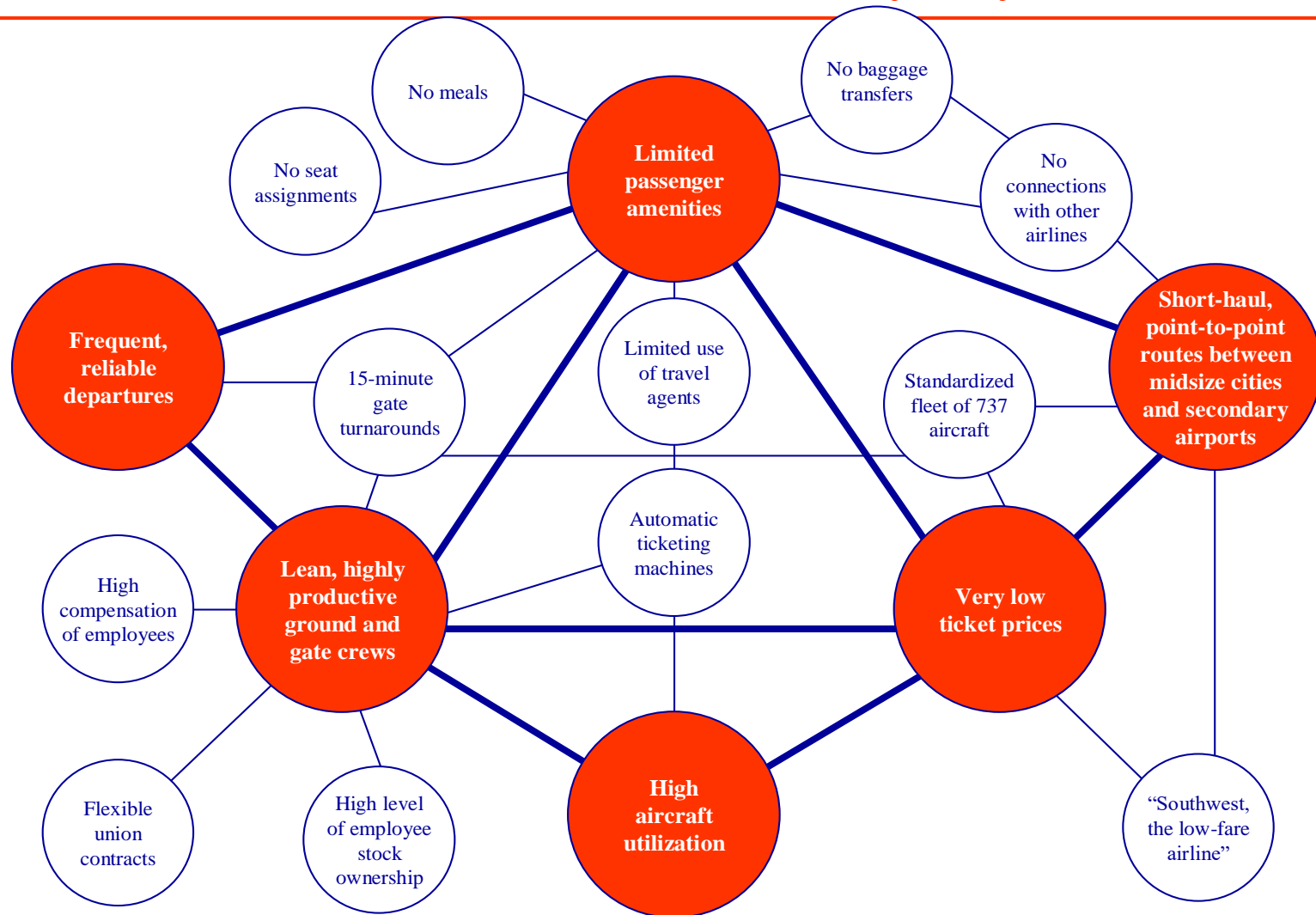
Strategic Coherence

- Combining activities that complement and reinforce one another. These activities dovetail together to help achieve the overall objectives of the firm.
- Such strategies, which may be regarded as *systems of activities* are often more successful because they are more difficult to imitate. Thus, they can lead to a sustainable competitive advantage.
- Strategic coherence may not be a sufficient condition for attaining a competitive advantage, but it is often a necessary one.





Southwest Airline's Activity System



Strategic Coherence

The Logic of How The Business Fits Together:

- **Southwest Airlines**

- Low Price
- Short Routes
- No Frills
- Point-to-Point
- One Aircraft -- Boeing 737
- High number of Aircraft per Route
- No Meals
- Flexible/ Lower Staffing



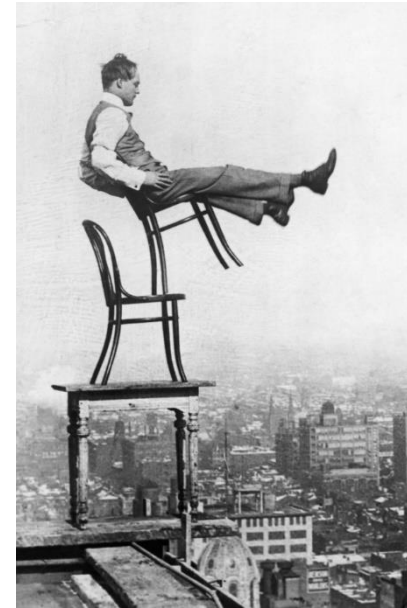
- **American Airlines**

- Premium Price
- Short, Long, & Int'l
- Variety
- Hub & Spoke System
- Multiple Aircraft
- Low number of Aircraft per Route
- Meals & Service
- Higher Staffing



Strategic Coherence: Fit and Balance

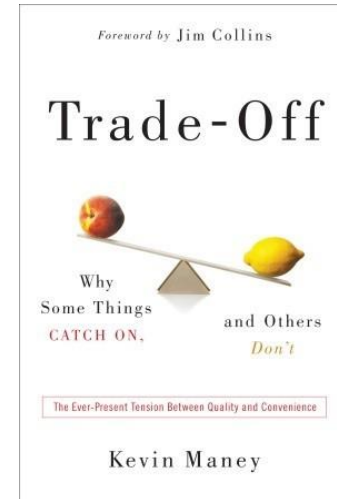
- A fit among corporate, business, and functional strategy;
- A fit between strategy formulation and implementation;
- A balance of commitment and flexibility;
- A balance among stakeholders;
- A balance of competition and cooperation;
- A balance of hiding and diffusing information;
- A balance of centralization and decentralization;
- A balance between stability and change.



Strategic Coherence

- A sustainable competitive advantage often requires trade-offs. These tradeoffs arise for at least three reasons:

- *Inconsistencies in image or reputation.*
- **Tradeoffs** arising from the activities themselves.
- *Limits on internal coordination and control*



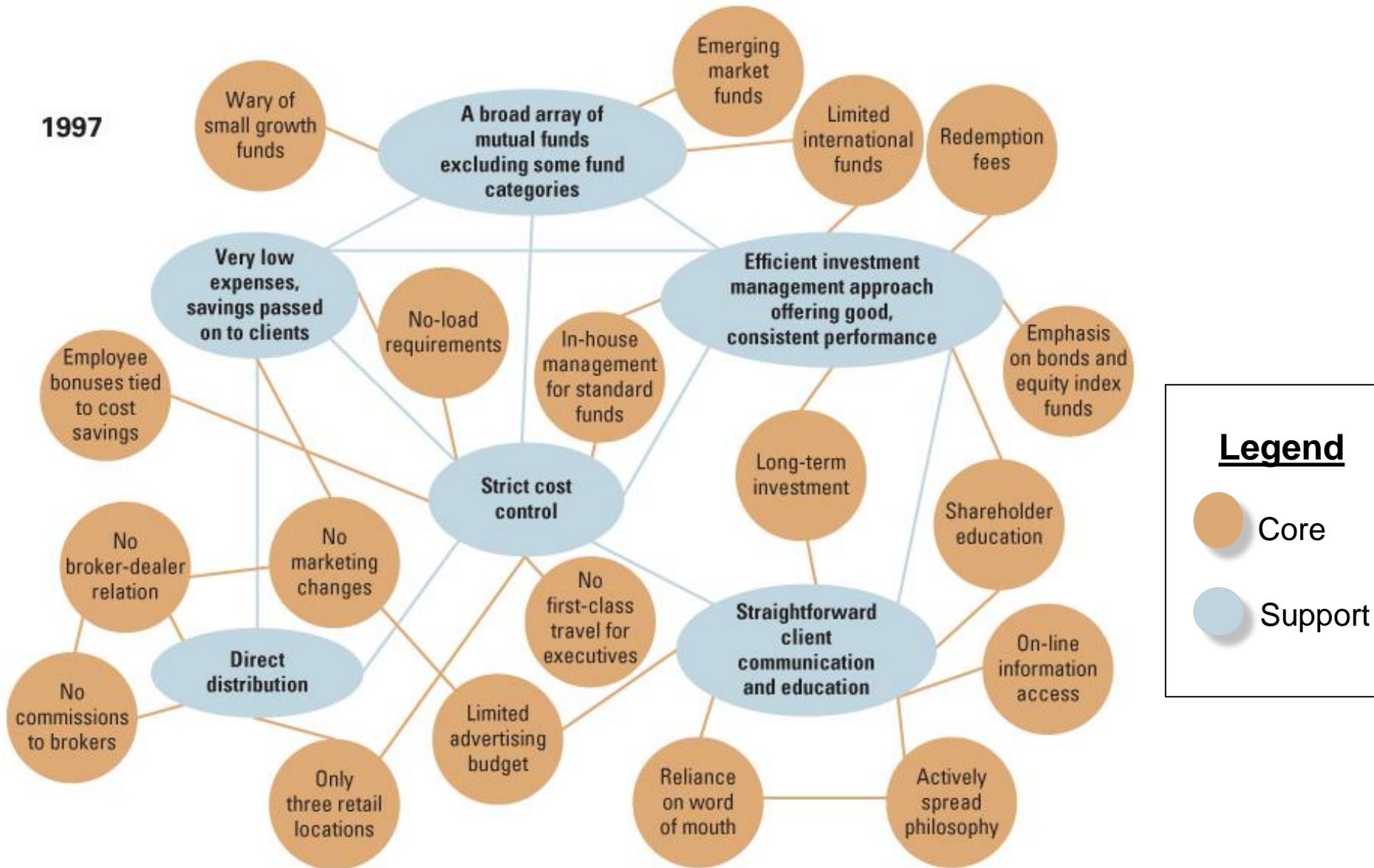
- General management at its core is strategy:
 - Defining and communicating the company's unique position;
 - Making tradeoffs; and
 - Forging a dynamic fit among activities (i.e., strategic coherence).

Dynamic Strategic Activity Systems

- A network of interconnected activities in the firm
- Evolve over time – external environment changes
 - Add new activities & upgrade or remove obsolete ones
- **Vanguard Example**
 - A global investment firm - \$1.4 trillion managed assets
 - ❖ Emphasis on low customer cost and quality service
 - Among the lowest expense ratios in the industry (0.20%)
 - Updated the activity system from 1997 to 2011
 - ❖ New customer segmentation core
 - ❖ Two new support activities
 - ❖ Permits customized offerings: long-term and more active traders

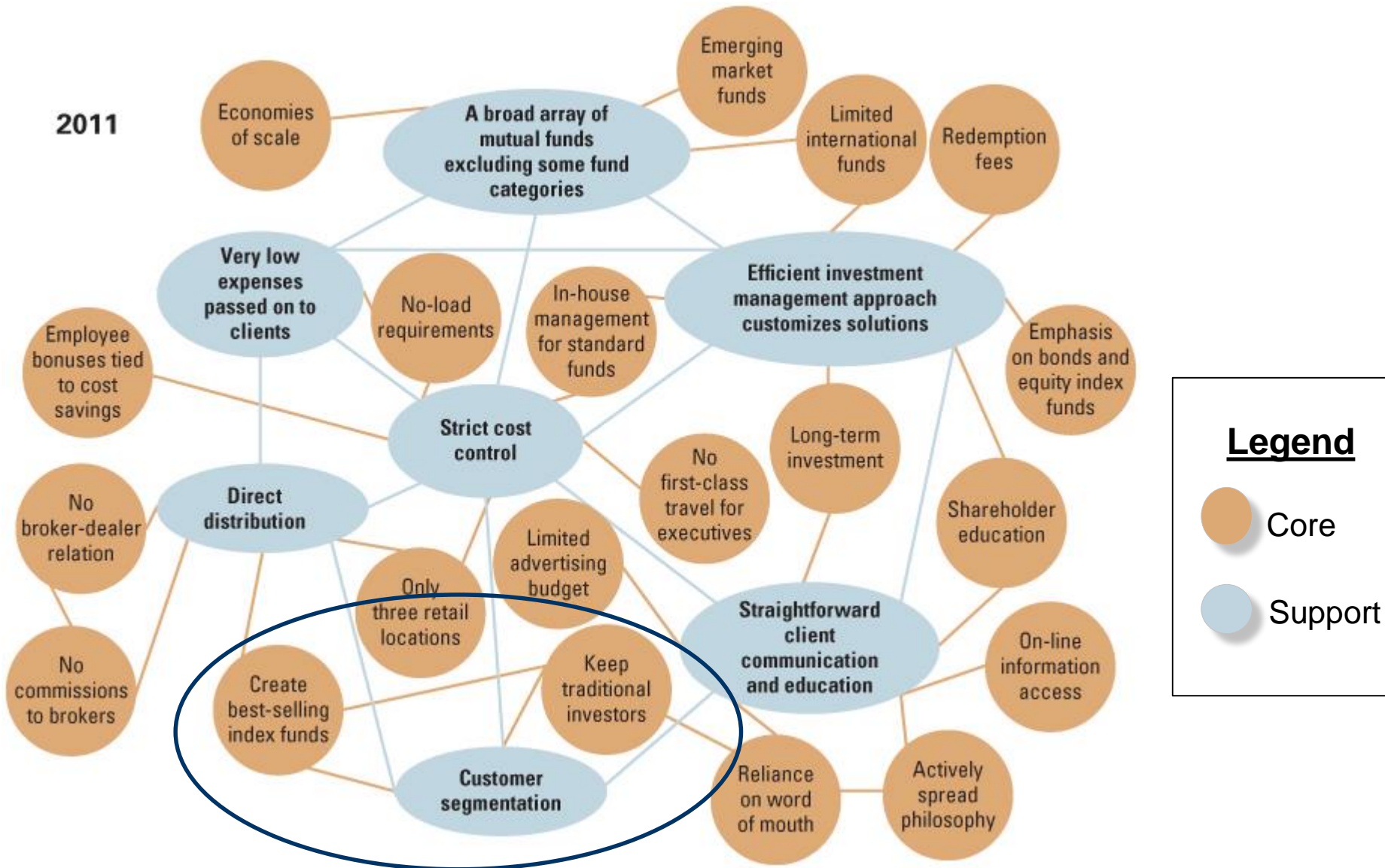
Vanguard Group's Activity System 1997

1997



Vanguard Group's Activity System 2011

2011



Starbucks

Mini-case #7 (pp. 443-445)

- To be a source of competitive advantage over time, core competencies need to be honed and upgraded. Why and how did Starbucks lose its uniqueness and struggle in the mid-2000s? What strategic moves did Howard Schultze make to re-create Starbucks's uniqueness after his return in 2008? Do you think Starbucks will continue to be successful?



Hollywood Studios Goes Global

Mini-case #21 (pp. 488-491)

- Consider the **SWOT matrix**. Given the economies of **the** now global movie industry, what are the strategic implications for Hollywood studios? What are some opportunities, and what are some threats? How should Hollywood movie studios take advantage of these opportunities, while mitigating threats?



	Opportunities (external, positive)	Threats (external, negative)
Strengths (internal, positive)	Strength-Opportunity strategies Which of the company's strengths can be used to maximize the opportunities you identified?	Strength-Threats strategies How can you use the company's strengths to minimize the threats you identified?
Weaknesses (internal, negative)	Weakness-Opportunity strategies What action(s) can you take to minimize the company's weaknesses using the opportunities you identified?	Weakness-Threats strategies How can you minimize the company's weaknesses to avoid the threats you identified?