

## Analyzing Firm Capabilities



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## The Fundamental Principle of Business Strategy

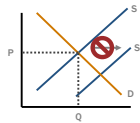
"If everyone can do it, it's difficult to create and capture value from it."

or, alternatively

"In a perfectly competitive market, no firm realizes economic profits (rents)."

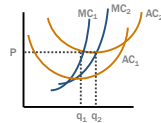
## Two Perspectives on Rents

**Monopoly Rents**  
(Industrial Organization View)



- Barriers to entry
- Industry structure matters

**Ricardian Rents**  
(Resource Based View)

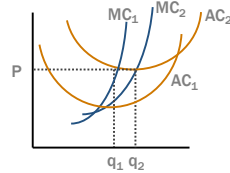


- Barriers to imitation
- Firm structure matters

## The Role of Firm Capabilities

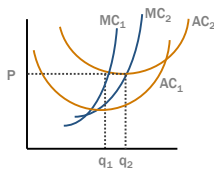
### • The Resource Based Perspective:

- Premise that firm capabilities matter most
- Economic rents due to barriers to imitation (i.e. Ricardian rents)
- Some firms are more profitable than others



## Cost vs. Demand Advantage

### COST ADVANTAGE



### DEMAND ADVANTAGE

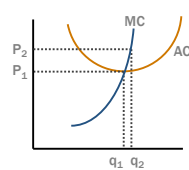




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## Analyzing Capabilities

- Identifying the value chain and specific resources and capabilities
- Assessing the alignment of capabilities both internally and externally
- Determining the degree to which any capability advantage is sustainable over time

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### Value Chain

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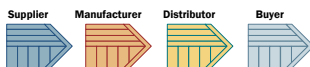
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## The Value Chain



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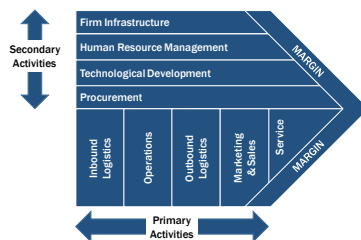
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## The Value Chain



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Resources to Capabilities

	Tangible	Intangible
People/ Assets	Cash Physical Plant Patents Talent	Brands Reputation Technical Expertise Loyalty
Systems/ Processes	Contracts/Alliances IT Systems	Positive Culture Talent Acquisition

Alignment

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## Alignment

- Internal Alignment
  - Are our processes, people, and systems aligned with each other?
  - Do they reinforce each other to build capability?
- External Alignment
  - Are capabilities aligned with the value proposition?
  - The "value" in a VRIN analysis
    - Valuable Rare Inimitable Non-Substitutable

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Alignment: Nucor Steel



Image Credit: Goodwin Steel Casting, <https://www.flickr.com/photos/51810025@N06/7305020468>

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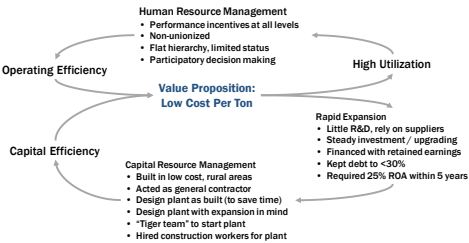
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Alignment: Nucor Steel



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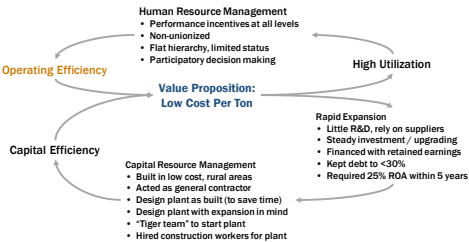
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Alignment: Nucor Steel



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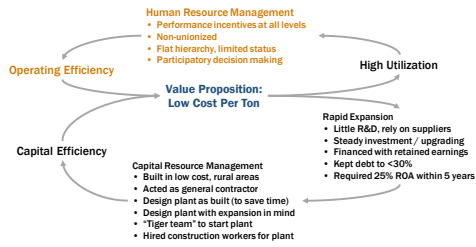
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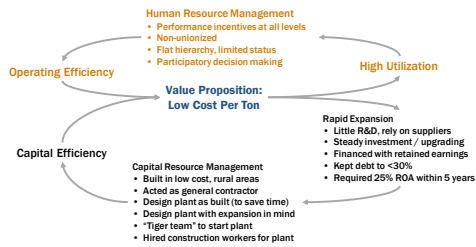
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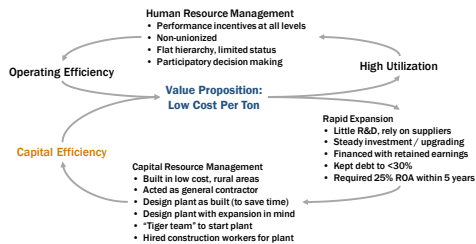
## Alignment: Nucor Steel



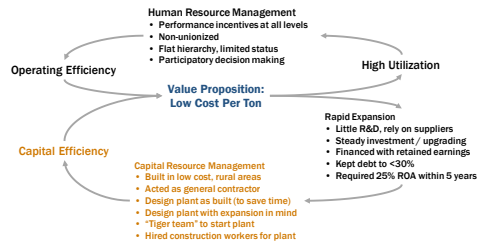
## Alignment: Nucor Steel



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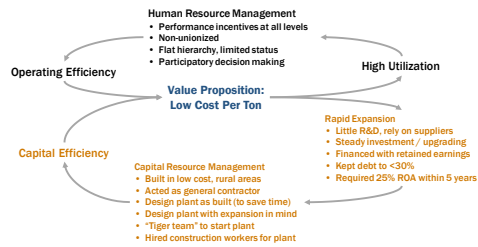
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### Alignment: Nucor Steel




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### Alignment: Nucor Steel



Image Credit: Goodwin Steel Casting, <https://www.flickr.com/photos/55810025@N06/1205052448>

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## Sustainability: Imitation

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## Sustainability

- The degree to which a competitive advantage is captured and sustained
  - Imitability
  - Durability

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## Sustainability

- Imitability
  - Can others do what we do?
  - Rarity and inimitability conditions of a VRIN analysis

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## Barriers to Imitation

- Legal barriers present
- Control scarce supply
- Developed over unique historical path
- Capabilities are socially complex
- Value derives from tight combinations
- Credibly commit a firm to a course of action
  - Can they be used to keep others from exploiting expanding opportunities?
    - Scalable
  - Are they limited to this purpose?
    - Specificity

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## Sustainability: Durability

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  - Imitability
  - Durability

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## Sustainability

- Durability
  - Can we maintain our capabilities over time?
  - Will they degrade or become obsolete?

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## Challenges to Durability

- Human and physical assets tend to degrade over time
- Core capabilities may become core rigidities
  - Success breeds complacency, risk aversion, myopia
- Valuable capabilities today may be obsolete tomorrow
- Some assets may be more valuable to others and thus are worth selling!

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## Building Capabilities

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How Do You Build Capabilities?

- **Alternative 1: Acquired from others**
  - Resource markets (e.g. labor, technology, patents)
  - Mergers & acquisitions
  - Alliances, associations, corporate venture capital
- **Limitations:**
  - Only viable if these factor markets (markets for things that firms buy) are imperfect!
  - Firm must have either superior information or pre-existing complementary capabilities (or luck)

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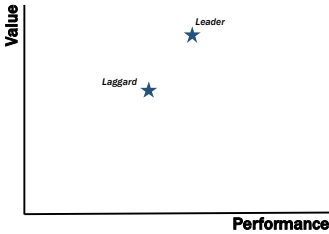
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Information vs. Complementarities



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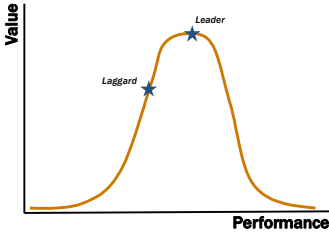
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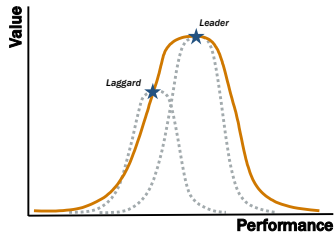
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## Information vs. Complementarities




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## How Do You Build Capabilities?

- **Alternative 2: Developed internally over time**
  - New product development and internal Research & Development
  - Knowledge management, training
  - Superior leadership
- **Limitations: Firm still must have either**
  - Superior information (know-why)
  - Pre-existing complementary capabilities (know-how)
  - Luck!

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## Module Lessons

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Module Lessons

- Capability analysis helps identify a firm's value-creating activities (i.e., strengths and weaknesses).
- Capabilities arise through the interaction of people, processes, and systems.
- To provide a sustainable competitive advantage, capabilities must be well aligned internally and externally, durable, and hard to imitate.
- Superior capabilities are either acquired or built and required superior know-why or know-how (or luck!).

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The Strategist's Toolkit:  
Capabilities Analysis

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Capability Analysis

CAPABILITIES	1. _____	2. _____	3. _____	4. _____
Processes				
People				
Systems				
Alignment				
Sustainability				

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