The Strategic Position 3: Strategic Capabilities
Learning outcomes

• Identify what comprises 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 non-substitutability (VRIN).

• Diagnose strategic capability by means of benchmarking, value chain analysis, activity mapping and SWOT analysis.

• Consider how managers can develop strategic capabilities for their organisations.
Strategic capabilities: the key issues

- What are strategic capabilities?
- How do strategic capabilities contribute to competitive advantage and superior performance?
- How to diagnose strategic capabilities?
- How to manage the development of strategic capabilities?

Figure 3.1  Strategic capabilities: the key issues
Resource-based strategy

The resource-based view (RBV) of strategy asserts that the competitive advantage and superior performance of an organisation is explained by the distinctiveness of its capabilities.
Resources and competences

- **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*.
## Components of strategic capabilities

<table>
<thead>
<tr>
<th>Strategic capability</th>
<th>Resources: what we have, e.g.</th>
<th>Competences: what we do well, e.g.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Machines, buildings, raw</td>
<td>Ways of achieving utilisation of</td>
</tr>
<tr>
<td></td>
<td>materials, products, patents,</td>
<td>plant, efficiency, productivity,</td>
</tr>
<tr>
<td></td>
<td>data bases, computer systems</td>
<td>flexibility, marketing</td>
</tr>
<tr>
<td></td>
<td>Balance sheet, cash flow,</td>
<td>Ability to raise funds and manage</td>
</tr>
<tr>
<td></td>
<td>suppliers of funds</td>
<td>cash flows, debtors, creditors etc.</td>
</tr>
<tr>
<td></td>
<td>Managers, employees, partners,</td>
<td>How people gain and use experience,</td>
</tr>
<tr>
<td></td>
<td>suppliers, customers</td>
<td>skills, knowledge, build</td>
</tr>
<tr>
<td></td>
<td></td>
<td>relationships, motivate others and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>innovate</td>
</tr>
</tbody>
</table>

Long-term survival and competitive advantage

Table 3.1 Components of strategic capabilities
Redundant capabilities

- Capabilities, however effective in the past, can become less relevant as industries evolve and change.
- Such ‘capabilities’ can become ‘rigidities’ that inhibit change and become a weakness.
Dynamic capabilities

Dynamic capability is the ability of an organisation to renew and recreate its strategic capabilities to meet the needs of changing environments.
Threshold and distinctive capabilities (1)

- **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 critically underpin competitive advantage and that others cannot imitate or obtain – ‘winners’.
Threshold and distinctive capabilities

<table>
<thead>
<tr>
<th></th>
<th>Resources</th>
<th>Competences</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Threshold</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>capabilities</td>
<td>Threshold resources</td>
<td>Threshold competences</td>
</tr>
<tr>
<td>Required</td>
<td>to be able</td>
<td></td>
</tr>
<tr>
<td>to compete</td>
<td>in a market</td>
<td></td>
</tr>
<tr>
<td><strong>Distinctive</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>capabilities</td>
<td>Distinctive resources</td>
<td>Distinctive</td>
</tr>
<tr>
<td>Required</td>
<td>to achieve</td>
<td>competences</td>
</tr>
<tr>
<td>competitive</td>
<td>advantage</td>
<td></td>
</tr>
</tbody>
</table>

Table 3.2  Threshold and distinctive capabilities
Core competences

Core competences¹ are the *linked set* of skills, activities and resources that, together:

- deliver customer value
- differentiate a business from its competitors
- potentially, can be extended and developed as markets change or new opportunities arise.

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
- non-substitutability

VRIN

VRIN (1)

V – Value of strategic capabilities

Strategic capabilities are of value when they:
• take advantage of opportunities and neutralise threats,
• provide value to customers
• provide potential competitive advantage
• at a cost that allows an organisation to realise acceptable levels of return
VRIN (2)

*R – Rarity*

• Rare capabilities are those possessed uniquely by one organisation or by a few others only. (E.g. a company may have patented products, have supremely talented people or a powerful brand.)

• Rarity could be temporary. (Eg: Patents expire, key individuals can leave or brands can be de-valued by adverse publicity.)
VRIN (3)

**$I$ – Inimitability**

Inimitable capabilities are those that competitors find difficult to imitate or obtain.

- Competitive advantage can be built on unique resources (a key individual or IT system) but these may not 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

Figure 3.2 Criteria for the inimitability of strategic capabilities
VRIN (4)

**N - Non-substitutability**

Competitive advantage may not be sustainable if there is a threat of substitution.

- Product or service substitution from a different industry/market. For example, postal services partly substituted by e-mail.
- Competence substitution. For example, a skill substituted by expert systems or IT solutions.
Criteria for the inimitability of strategic capabilities

<table>
<thead>
<tr>
<th>V</th>
<th>Value: Do capabilities exist that are valued by customers and provide potential competitive advantage?</th>
</tr>
</thead>
<tbody>
<tr>
<td>R</td>
<td>Rarity: Do capabilities exist that no (or few) competitors possess?</td>
</tr>
<tr>
<td>I</td>
<td>Inimitability: Are capabilities difficult for competitors to imitate?</td>
</tr>
<tr>
<td>N</td>
<td>Non-substitutability: Is the risk of capability substitution low?</td>
</tr>
</tbody>
</table>

Increasing bases of sustainable competitive advantage

Figure 3.3  VRIN
Organisational knowledge

**Organisational knowledge** is the collective intelligence, specific to an organisation, accumulated through both formal systems and the shared experience of people in that organisation.

Some of this knowledge is ‘**Tacit**’ knowledge that is, more personal, context-specific and hard to formalise and communicate – so it is difficult to imitate, for example, the knowledge and relationships in a top R&D team.
Benchmarking is a means of understanding how an organisation compares with others – typically competitors.

Two approaches to benchmarking:

- **Industry/sector benchmarking** - comparing performance against other organisations in the same industry/sector against a set of performance indicators.

- **Best-in-class benchmarking** - comparing an organisation’s performance or capabilities against ‘best-in-class’ performance – wherever that is found even in a very different industry. (E.g. BA benchmarked its refuelling operations against Formula 1).
The value chain

• *The value chain* describes the categories of activities within an organisation which, together, create a product or service.

• The value chain invites the strategist to think of an organisation in terms of sets of activities – sources of competitive advantage can be analysed in any or all of these activities.
Figure 3.4 The value chain within an organisation

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The value network

- **The value network** 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 network.
Figure 3.5 The value network

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Uses of the value chain

• A *generic description of activities* – understanding the discrete activities and how they both contribute to consumer benefit and how they add to cost.

• *Identifying activities* where the organisation has particular strengths or weaknesses

• *Analysing the competitive position* of the organisation using the VRIN criteria – thus identifying sources of sustainable advantage.

• Looking for ways to *enhance value or decrease cost* in value activities (e.g. outsourcing)
Uses of the value network

- **Understanding cost/price structures** across the value network – analysing the best area of focus and the best business model.
- **Identifying ‘profit pools’** within the value network and seek to exploit these.
- **The ‘make or buy’ decision**: deciding which activities to do ‘in-house’ and which to outsource.
- **Partnering and relationships** – deciding who to work with and the nature of these relationships.
Mapping activity systems (1)

- *Identify ‘higher order strategic themes’* that is, how the organisation meets the critical success factors in the market.
- *Identify the clusters of activities* that underpin these themes and how they fit together.
- *Map* this in terms of how activity systems are interrelated.
Mapping activity systems (2)

Illustration 3.5 Activity systems at Geelmuyden.Kiese
Using activity system maps

- A means of *identifying strategic capabilities* in terms of linkages of activities
- *Internal and external links* are identified (e.g. in terms of the needs of customers).
- Therefore helps identify *bases of competitive advantage*.
- And *sustainable advantage* for example, in terms of bases of inimitability.
SWOT analysis

**SWOT** summarises the strengths, weaknesses, opportunities and threats likely to impact on strategy development.

**INTERNAL**
- **STRENGTHS**
- **WEAKNESSES**

**EXTERNAL**
- **OPPORTUNITIES**
- **THREATS**
Uses of SWOT analysis

• Key *environmental impacts* are identified using the analytical tools explained in Chapter 2.
• Major *strengths and weaknesses* are identified using the analytic tools explained in Chapter 3.
• *Scoring* (e.g. + 5 to - 5) can be used to assess the interrelationship between environmental impacts and the strengths and weaknesses.
• SWOT can be used to examine strengths, weaknesses, opportunities and threats *in relation to competitors*.
• SWOT can be used *to generate strategic options*—using a TOWS matrix.
Figure 3.6  The TOWS matrix
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 Chapters 2 and 3.

• SWOT is *not used to guide strategy* – it is seen as an end in itself.
Developing strategic capabilities (1)

Internal capability development:

• **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.
Developing strategic capabilities (2)

- **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 understand sources of consumer benefit and enhance anything that contributes to this.
- **Managing the capabilities of people** – training, development and organisation learning.
Chapter summary (1)

- **Strategic capabilities** comprise both resources and competences.
- The concept of *dynamic capabilities* highlights that strategic capabilities need to change as the market and environmental context of an organisation changes.
- **Sustainability** of competitive advantage is likely to depend on an organisation’s capabilities being of at least *threshold value* in a market but also being *valuable*, relatively rare, *intangible and non-substitutable*. 
Chapter summary (2)

Ways of *diagnosing organisational capabilities* include:

• *Benchmarking* as a means of understanding the relative performance of organisations.

• Analysing an organisation’s *value chain and value network* as a basis for understanding how value to a customer is created and can be developed.

• *Activity mapping* as a means of identifying more detailed activities which underpin strategic capabilities.

• *SWOT analysis* as a way of drawing together an understanding of strengths, weaknesses, opportunities and threats an organisation faces.